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TECHNICAL PAPER NO. 2

Background Study on Economic Measures for Historic and Heritage Building Conservation and Restoration in Ontario

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Background Study on Economic Measures for Historic and Heritage Building Conservation and Restoration in Ontario

Prepared by
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Background Study on Economic Measures for Historic and Heritage Building Conservation and Restoration in Ontario

In 1987 the provincial government initiated the Ontario Heritage Policy Review (OHPR) - a comprehensive review of Ontario's heritage policies, legislation, and programs. OHPR had as its purpose the development of an overall policy framework and guiding vision within which government programs and legislation could be developed.

Background Study on Economic Measures for Historic and Heritage Building Conservation and Restoration in Ontario is one of a number of studies produced for the Review. A list of these is found on the last page.

This study was prepared for the Review by Marc Denhez. The views and opinions expressed are the author's and do not necessarily reflect those of the Ministry of Culture and Communications.

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EXECUTIVE SUMMARY

In the 1990s, urban development is expected to undergo significant change, as the number of new housing starts drops and the "renovation sector" rises. Measures to improve the competitiveness of the older building stock (in general) and heritage buildings (in particular) could therefore prove most timely for the housing industry and the Ontario economy. They may also complement "sustainable development" policies in the urban context.

Although the very word "incentives" raises concerns in industry circles, all the parties involved are continuing a concerted search for policies that will induce a better investment climate for the conservation and rehabilitation ("rehab") of the older building stock, particularly heritage buildings and districts. The courts have coincidentally contributed to that process in the *Goyer* and *Gold Bar* cases by opening new possibilities for tax-deductible renovations. These judgments suggest that renovations on investment properties are tax-deductible unless they add to the building physically, replace disappeared items, or are inconsistent with what the building would be worth normally. The exact scope of the consequences is unclear, and a new interpretation bulletin is expected from Revenue Canada.

Court cases and new appraisal practices are also influencing property tax. There is a risk that these influences could deter heritage designations and rehab. Accordingly, several jurisdictions have introduced favourable tax measures on their own terms. The preferred technique is to rebate the tax increases flowing from rehab on designated heritage properties.

There are three main avenues wherein to influence the "bottom line" on heritage-oriented investments: tax, regulatory, and supportive measures; they can be accomplished variously by provincial, joint provincial-municipal, or municipal action.

First, on the tax front, there is not only income tax and property tax, but also sales tax. Furthermore, there are special ways to spend incremental tax revenue flowing from rehab (e.g. tax increment financing).

Second, on the regulatory front, various measures can improve competitiveness (e.g. hours of opening, reducing holding time on projects) or otherwise cut red tape (e.g. code approvals, zoning trade-offs).

Third, the supportive side can use a variety of measures. There are interesting precedents for development corporations, some of which have preferential access to private capital (e.g. via RRSPs, the Investor/Immigrant Program, the Small Business Development Corporation program). Other measures address the concerns of the renovation industry (e.g. education, access to professional advice, certification, and warranties). Some

increase the marketability of heritage investments (e.g. a preferential public-sector market, target marketing in the private sector, encouragement of joint action among developers, and business incubators). Other financing techniques include loan guarantees, equi-bonds, "Cannie Maes," or mortgage-backed securities, and other new kinds of loans. Finally, there are compelling arguments for closer co-operation between heritage-oriented programs and initiatives stemming from tourism and housing programs and the housing industry itself.

The three types of approaches - tax, regulatory, and supportive - are not presented in order of preference; some are not even necessarily appropriate for Ontario. However, they constitute a useful starting-point to understand the techniques whereby Ontario may foster development and use of heritage properties.

1 CONTEXT

1.1 INTRODUCTION

During the course of the Ontario Heritage Policy Review, a consistent theme has been the importance of increasing investment in Ontario's heritage buildings and districts. The ministry's discussion paper, *Heritage: Giving Our Past a Future*, made prominent mention of both "carrots and sticks."[1] The public consultation process that followed witnessed a plethora of recommendations on the same theme from across the province; these were referred to again in the *Summary of Public Submissions*.[2] At the provincial meeting of local architectural conservation advisory committees (LACACs) in Sault Ste Marie in June 1988, one representative of the Review aptly summarized the challenge as representing "sweeter carrots and bigger sticks." At a further consultative meeting in September 1988, involving representatives of national and provincial heritage associations, other phrases expressed the same objective: to develop "market-driven" systems for heritage, whereby "heritage would become competitive" with the alternatives.

That challenge lies at the basis of this paper. There is a consensus among all interested parties that the time has come to explore the economic measures (either directly financial or indirectly commercial) that can improve investment patterns.

Over fifteen years ago, the Heritage Canada Foundation was describing "financial support" as one of the "three pillars" of heritage legislation.[3] At first, conventional wisdom assumed that this support would come in the form of cash (i.e. direct grants). It did not take long, however, for observers to notice that few governments in North America would even admit to having enough money to do the job. At the same time, almost every country in the Western world (including the United States, France, West Germany, the Netherlands, and Belgium) was moving in the direction of tax incentives; many Canadians in the heritage community wanted to follow suit.[4]

By the mid-1980s, however, the pendulum had swung again. The "tax reform" movement had taken hold, and "tax incentives" were falling into disrepute in both Canada and the United States. Admittedly, the U.S. tax reform measures of October 1986 maintained the renovation industry as one of the few preferred industries under the Internal Revenue Code, but only because of a formidable lobby mounted by major American municipalities. For that reason, prospects for achieving a comparable system in Canada are considered small by most observers. In fact, for reasons that will be outlined in section 2.1, the notion of "tax incentives" may not even be desirable when compared to the notion of a fiscal "level playing-field," in which various decisions affecting property are all fiscally neutral.

That creates a dilemma, for if one leaves aside financial subsidies and tax incentives, what is left?

The answer is that many conceivable measures remain to induce investment, in ways that do not require large amounts of public funding and are consistent with the notion of fiscal neutrality. They will be the primary focus of this study.

1.2 BACKGROUND

A convergence of economic forces militates in favour of the rehabilitation ("rehab") of communities. Those forces are affecting what the housing industry calls the "reno sector," the portion of the industry that specializes in repair, rehabilitation, additions, alterations, and maintenance. Those specialties clearly cover a broader spectrum than the rehabilitation of heritage buildings. However, because of the significant overlap between the interests of the renovation industry (as described later in this study) and those of the heritage constituency, it is important to review the economic forces at work.

The articulation by the World Commission on Environment and Development (the Brundtland Commission) of strategies for "sustainable development" contrasted with the previous pattern of urban development. The new construction that cities relied on for their tax base triggered greater demands on municipal infrastructure. With the rising cost of that infrastructure, cities like New York were going bankrupt. The reno sector, which increases property values and the economy without making corresponding infrastructure demands, has now been adopted as the vehicle of choice for the growth and increase in tax base of many North American cities.'[1][12][3][4][5]

That change coincides with a shift in the private sector. If new housing starts in Canada drop, as predicted, from 247,000 per year to 190,000,[6] the private sector will have to compensate somehow, and the reno sector appears promising.[7] Consider several factors.

- In 1982, only 21 per cent of Canadian homes were over forty years old; but that figure will jump to 40 per cent by 1999.[8]
- Canada Mortgage and Housing Corporation (CMHC) predicts that the reno sector will generate $230 billion over the next twenty years.[9]
- A recent Environics study predicts that the reno sector will grow at 20 per cent per year over the next decade.[10]
- The reno sector already employs 200,000 Canadians directly[11] and has a growth rate twice that of new construction.[12]
- In North America, investment in the reno sector surpassed new construction some five years ago;[13] in some areas (e.g. New

England) over 70 per cent of all construction-related investment is in that sector."

- MacLean-Hunter predicts that, by the year 2000, over 80 per cent of Canadian construction-related investment (presumably on the residential side) will be in this sector."

- CMHC has established that this sector, dollar for dollar, creates over twice as many direct jobs as new construction."

Over 80 per cent of the buildings that Ontario's residents will occupy in the year 2000 have already been built. A very significant proportion (probably close to $40 billion worth) of those structures antedate the Second World War." That is a large investment. If Ontario is to capitalize on that investment, it must consider how to do so.

At stake is not only the future of this building stock; that future also affects thousands of jobs, hundreds of millions of dollars of potential new investment, many of Ontario's foremost tourist attractions, and the net development of the municipal tax base." The potential in Ontario for heritage-oriented investment and development is almost limitless. That potential can be exploited, if the proper techniques are used to full capacity.

This study will outline a variety of measures which can be considered for that purpose. Many have already been tried and have proven both feasible and advantageous. The United States provides a case in point. The accomplishments there are not only economic; they go to the very relationship between the owner of an older building and the state. In Ontario, designation of heritage properties carries regulatory controls, but almost no economic benefits; in the United States, that situation is reversed. Not surprisingly, in Ontario virtually all the "appeals" by owners under the Ontario Heritage Act have been undertaken by proprietors who objected to designation." The U.S. heritage system has an appeal procedure too, under the auspices of the federal Department of the Interior, but virtually all appeals are by owners who have been denied designation and who seek it because it will improve the economic situation of their rehab project. That is the extent to which the climate for heritage and rehabilitation has been changed.

This is not to say that Ontario should abandon its existing regulatory framework in favour of an overwhelmingly economic approach, as in the United States. The paucity of adequate regulatory controls in the United States is an ongoing problem there, which the use of "incentives" cannot solve entirely. Nevertheless, such techniques have motivated the U.S. private sector and have prompted a more co-operative approach toward the country's heritage building stock. It is therefore no surprise that the United States has a half-million heritage buildings on its National Register of Historic Places, some fifty times as

many as Canada has listed. On a per-capita basis, the United States has almost six times as many designated buildings.

Even allowing for differences in population, the United States has been able to proceed much more rapidly because it had more support from developers. The United Kingdom has approximately forty times as many designated buildings per capita as Ontario. That discrepancy is not the result only of relative age; the system is geared to accommodate protection and rehabilitation.

A strategy for influencing heritage-oriented development in Ontario can involve both negative and positive inducements. One side can be called regulatory: that is, the control of factors that affect Ontario's heritage resources. The other side can be called economic: forces that will lead to a market-driven heritage system by increasing economic return on desired forms of development. The optimal result is an inconspicuous system with a regulatory grid that is usually redundant because other forces induce the private sector and municipalities to invest in heritage properties.

The techniques being considered to promote a better climate for heritage-oriented investment have often been referred to as "incentives"; for example, initiatives in taxation have sometimes been labelled "tax incentives." There is an unfortunate ambiguity in that expression. Anything that induces a given pattern of behaviour may be labelled an "incentive." However, connotations can be quite different, particularly in public debate over national and provincial economic policy, government strategies, and the relationship between such strategies and the development industry.

1.3 INTERNATIONAL BACKGROUND

Any study of the economic dimensions of heritage initiatives must take into account certain larger economic priorities. One notable example, already alluded to, is the world-wide emphasis on gearing the economies of nations and regions to the goal of "sustainable development" - in other words, patterns of economic growth that minimize counterproductive side-effects (such as resource depletion and environmental contamination). If the issue of ongoing use and rehab of heritage buildings is positioned correctly vis-à-vis the broader goal of "sustainable development," economic strategies for heritage conservation can play a very positive role in Ontario.

The above objective fits squarely with the Brundtland Commission's goal of "sustainable development," and it is one to which the Government of Ontario is already committed. When applied to the urban environment, that objective translates into maximization of jobs, economic growth, and public finan in conjunction with maximum capitalization on existing resources, minimum disruption of existing infrastructure, and minimum waste.

"Sustainable development," in the urban context, would refer to full realization of the potential of the existing building stock. In the natural environment, it means development that minimizes its own harmful effects. Ontario's heritage of older buildings does not represent all of the province's resources for "sustainable development," but it is an obvious place to start.

Another international economic trend affecting heritage activities is the pattern of development in other countries. In Europe, various economic strategies have for many years promoted investment in the heritage building stock.[20] In North America, the integration of renovation (of older building stock) into overall economic priorities occurred more recently. The largest step in that direction, in the United States, took place in 1981 with adoption of extensive tax inducements for renovation in the Economic Recovery Tax Act, on the initiative of the Reagan administration. The act provided unabashed tax incentives, both for certified historic properties and for renovation of more modest non-residential buildings over a certain age. The intention was to reverse fiscal bias against conservation and sympathetic development of old properties[21] and to promote investment in these properties. In the words of the then Secretary of the Interior, investment in heritage resources could be viewed as a "tool to revitalize communities and strengthen the nation's economy..., (to) maximize private capital, create new jobs and bring about economic revitalization."[22]

Since 1981, total renovation investment in the United States has almost continuously exceeded investment in new construction. Although that exponential growth is based upon many more factors than mere tax treatment (e.g. shifts in public tastes and other market factors), the public sector's stated policy of supporting these investments had a significant catalytic impact. The ripple effect is now being felt continent-wide, including in Ontario.

Treaty obligations also affect heritage activities. In 1976 Canada signed the UNESCO World Heritage Convention on behalf of the federal government, the two territories, and nine of the ten provinces, including Ontario.[23] That treaty specifies signatories' obligation "to adopt a general policy which aims to give the cultural and natural heritage a function in the life of a community"[24] and "to take the appropriate legal ... and financial measures necessary for the ... conservation, preservation and rehabilitation of this heritage."[25]

1.4 OUTLINE OF THIS REPORT

This report will outline the precedents for strategies to facilitate further investment in heritage properties and will show their general success and applicability. A variety of sources were used in the preparation of this report. Studies, reports, books, and articles as cited in the notes, as well as interviews and discussions with industry and government representatives.

The first issue to be considered (in chapter 2) will be that of income tax, for two reasons: Ontario has its own income tax system, which is "piggy-backed" on the national system, and recent jurisprudence has affected the overall tax picture for renovations on most investment properties. Participants in future dialogue between government and the private sector on development of policies to promote investment will need to be fully conversant with existing ways of calculating profitability, in which tax treatment plays a major role.

The second issue examined (in chapter 3) is property tax, whose importance to investment decisions is self-explanatory.

Chapter 4 provides a brief advance summary of the tax, regulatory, and supportive measures, examined in chapters 5-7.

The study turns to other discrete measures which may facilitate rehab or otherwise affect the "bottom line" on such decisions. Those measures are being advanced for discussion only; they are not yet at a level of analysis and specificity that would allow the Province to adopt an actual blueprint for implementation. Some measures may, upon reflection, prove inappropriate for adoption. Nonetheless, these measures represent precedents advanced elsewhere, which Ontario may consider to have at its disposal.

If adopted, some measures could be introduced exclusively at the provincial level (chapter 5). Others are of exclusively municipal jurisdiction (chapter 7). Still others overlap (chapter 6): building codes, for example, are adopted provincially, but case-by-case implementation is administered locally. Measures may be categorized also as regulatory or financial: tactics to reduce red tape or to affect hours of opening are regulatory; tactics for access to venture capital or to sponsor development corporations are financial.

If Ontario assembles a comprehensive strategy to involve the private sector more closely in heritage conservation and rehabilitation, none of its elements can be labelled "experimental." However, Ontario would be the first province in Canada to assemble all these tactics into a single strategy. In that sense, Ontario would be in the forefront of Canadian jurisdictions.

2 INCOME TAX TREATMENT

2.1 BACKGROUND

There has been discussion of the income tax treatment of heritage and rehab since the early 1970s. By the late 1970s, Canada was one of the few Western countries not to have a series of tax incentives to induce investment in this sector. The chronology of events, up until the mid-1980s, is described in a report prepared for the Buildings Revival Coalition in 1986, *For Economic Renewal: Building Rehabilitation and National Economic Priorities.*[6]

The focus of the discussion was "tax incentives"; that created policy problems, particularly with national organizations such as the Canadian Home Builders' Association (CHBA). The word "incentives" has negative connotations for the industry because it smacks of a government "hand-out" that not only distorts the market but also can lead to an artificial "boom-and-bust" cycle when the hand-out is withdrawn. The CHBA, therefore, has expressed profound reservations about anything that is even labelled an "incentive." Such reservations are expressed as forcefully when the benefits are supposed to accrue to its own members as when they accrue elsewhere. However, certain existing tax mechanisms (e.g. property tax increases following the rehab of buildings) are frequently viewed as disincentives; corrective measures would therefore be viewed, within the private sector, less as an incentive than as merely a return to the "level playing-field" via elimination of a punitive approach to rehab and building beautification.

Fortuitously, there was a turn of events that did not lead to an "incentive" per se but instead redefined the scope of the "level playing-field." Since this series of events is essentially a reinterpretation by the courts of longstanding tax rules, it does not run afoul of the CHBA's concerns about "incentives" or "preferential treatment."

That turn of events is the case entitled *SMRQ v. Goyer* (or the *Goyer* case).[7] The case involved a challenge by a Montreal woman, Mme Denise Goyer, regarding the tax treatment of expenses incurred in making repairs to her apartment building. Expenses that Mme Goyer had claimed were deductible had been treated by the government as capital and therefore not deductible for tax purposes. The case went to Quebec Provincial Court, which agreed with Mme Goyer that, under certain circumstances, expenses that had up until then been treated as capital should instead be treated as deductible current expenses. The Quebec Court of Appeal in 1987 upheld the decision on appeal from Revenue Quebec.

Over two years have elapsed since the Supreme Court of Canada disposed of the case on October 24, 1987, by refusing to grant Revenue Quebec leave to appeal; yet observers are still wondering whether the Quebec Court of Appeal's decision, as upheld by the Supreme Court, will transform the face of Canadian cities. Even

after these many months, reaction of the people most directly affected - renovators - was summarized by a contractor at the Construct Canada conference in May 1988: "It seems too good to be true, but I'm sceptical of things that seem too good to be true."

The *Goyer* case did seem too good to be true for owners and renovators of older buildings; however, a similar conclusion appears to have been reached (quite independently) by the Federal Court in the case of *Gold Bar Developments Ltd. v. R.*[2] It appears to expand drastically the scope of tax-deductible expenses when work is undertaken on investment properties.

This issue of tax treatment applies only to investment properties (commercial, industrial, rental residential, and so on). Principal and secondary residences are generally outside the ambit of the income tax system. The focus of this discussion is therefore on commercial and industrial owners and on landlords.

2.2 THE GOYER CASE

The *Goyer* case and the relevant jurisprudence are described in detail in Appendix A. The basic conclusion of that case was articulated by Mr. Justice Vallerand of the Quebec Court of Appeal. Concerning maintenance and repair to an investment property, as long as one is

- not creating new capital property,
- not increasing the normal capital value of the property, and
- not replacing a disappeared item with another,

such activities constitute "maintenance and repair which tends to return the capital specifically to its normal value ... replacement (of building components) is not a replacement of the capital property itself but merely a repair."[3]

2.3 APPLICATION TO DIFFERENT KINDS OF WORK

How can one feel confident that a given project passes the *Goyer* test and qualifies as "maintenance and repair"? The first two components of the test are straightforward: the project cannot physically add to the property and cannot replace items that had disappeared for a lapse of time. But the third criterion is immensely more difficult: how can one state that a project does not change the "normal" value of the building?

The court provided very little guidance to answer that question. It did indicate that it is disposed to treat as a current expense a project that merely does, in one swoop, what could have been done gradually (e.g. replacing an entire balcony rather than replacing it board by board). Perhaps more significant, the court bluntly concluded that new plumbing, new doors, new

windows, and new balconies were current expenses when they merely replaced worn-out building components.

That appears to open a giant door to the deductibility of project expenses that had heretofore been considered capital. The Canadian industry, in residential renovation and repair, is estimated at $18 billion annually; although a large component of that amount clearly creates something new (e.g. kitchen modernization), another sizeable portion clearly confines itself to replacement (e.g. heritage rehab).

Other kinds of projects fall into a grey area in the middle. For example, would rewiring (e.g. replacement of aluminum with copper) be considered a replacement or not? At first blush, the *Goyer* case suggests that it would and hence would be tax-deductible. However, that appears to undercut an old guideline dating from 1889, that a substitution of materials usually implies upgrading;[10] however, even that notion was open to doubt.[11] A change of materials was not fatal to deductibility in *Goyer*; in fact, both the piping and the windows underwent such changes. In the case of the piping, the rationale was easy: current building codes no longer allowed pipe of the same material as originally used. The windows were more problematic: wooden windows were replaced with aluminum. Appearance was similar, but that did not appear to be a factor in the court's decision. Instead, the court appeared to assume that the upgrading, in the move from wood to aluminum, was so modest that it did not warrant capitalization. A more conspicuous upgrading of materials would presumably have been treated differently.

One gets the impression that the court was leaning toward the notion that buildings have a "state of entropy," so to speak. That is the state that presumably prevailed immediately after they were built, and for which they were designed. It is arguable that this is a building's "normal" condition, which would continue so long as the building were properly maintained and worn-out parts periodically replaced. If the court did indeed mean "state of entropy" when it referred to the "normal" state of a building, this could conceivably represent a workable new test for the future, to assist in categorizing capital and current expenses.

In the meantime, however, the decision conveys the impression that substitution of materials no longer triggers a presumption of "capital" expenses. If that is the outcome, it is not necessarily favourable to heritage conservation, since replacement of existing materials with new and different ones would have as favourable tax consequences as repair or replacement of original materials. In fact, if any rollback of the case were to be discussed, this is one feature on which federal-provincial discussions could focus.

Is deductibility confined to those works which, instead of being done in one shot, could have been done in tax-deductible "dribs and drabs"? The court used balconies as an example. These could

have been repaired plank by plank, and since such partial work would have been tax-deductible under the status quo ante, it remains tax-deductible when done in one shot. However, that alone does not explain why doors and windows can now be tax-deductible under *Goyer*: a window cannot usually be repaired in dribs and drabs. It therefore appears that deductibility is not confined to works that could have been done in dribs and drabs.

Many projects on older buildings combine replacement and renovation. For example, a major project may not only fix walls but also move them around, add a skylight or two, and so on. If a "repair" project happens to include a slight amount of alteration, does that trigger the section in the Income Tax Act that would render the entire project capital? A reading of the act suggests, at first glance, that the answer is affirmative. If so, that would lead to the awkward conclusion that, in order to benefit from the *Goyer* precedent, a project would have to constitute pure replacement, "untainted" by any upgrading of materials (which might be labelled "renovation") or by physical changes ("alteration"). Again, a firm answer might require further jurisprudence; if separating types of work proves necessary, it could significantly affect the staging of work on a project. In fact, the entrepreneur may wish to set up the work schedule in such a way as to distance upgrading work clearly from replacement work, so as to distinguish "repair" from "renovation" components.

2.4 APPLICATION TO DEVELOPERS

When one reads the *Goyer* judgment verbatim, there appears to be no room for equivocation: the language admits of no qualifiers.

In December 1987, however, two months after the Supreme Court of Canada's ruling, Revenue Quebec issued its own interpretation bulletin which did introduce a qualifier. In essence, it purported to exclude developers from eligibility.

That distinction is important. Some rehab projects are undertaken on behalf of longstanding owners; others, for developers who have just recently acquired the property. The distinction invoked by Revenue Quebec would allow the former to benefit from the *Goyer* case, but not the latter.

The argument is as follows. If an entrepreneur acquires a property with the immediate intention of proceeding to its rehab, he or she could view projected rehab expenses as a component of acquisition cost. Since acquisition cost is itself a capital expense, the rehab (by this reasoning) would also be assimilated to capital expenses.

The above argument would be unassailable, but for two factors. First, it is not what the court actually said; in fact, it is difficult to reconcile with what the court actually said."

Second, it means that the capital or current nature of the expenditure becomes contingent on a subjective test. That raises the question of whether such an approach is even administrable.

The CHBA has written to the minister of national revenue requesting clarification by way of an interpretation bulletin. Although the CHBA's overtures have held back on full-scale advocacy, the shortcomings of Quebec's interpretation bulletin (concerning developers at least) have been identified. At the time of writing this study, a response was pending.

2.5 APPLICATION TO CALCULATION OF INCOME

There is a distinction between most types of tax deduction and tax shelters. A tax shelter is a category of deduction that can be applied not only against the income that that investment is producing but against other income as well. Such was the case with multiple-unit residential buildings (MURBs), which were a popular tax shelter in the 1970s. Deductions on MURBs could be claimed against not only MURB income but also other earnings. For example, doctors who owned MURBs could claim the deductions not only from their real estate income but also against their medical fees; the MURB was used to "shelter" a part of the medical income.

That is not the case with deductions that fail to qualify as "shelters." *Goyer*-type deductions, for example, are not shelters; accordingly, they can be applied only against the real estate earnings involved. For many owners whose real estate is producing only a trifling income, *Goyer*-type deductions will therefore provide only modest assistance. Where the deduction exceeds income from that investment, the resulting "loss" is nevertheless claimable over a period of seven years. The alternative, if the expense had been "capital," would have been as follows: the expenditure would be depreciable, at the modest rate of 4 per cent per year.

To summarize, therefore, *Goyer* treatment allows rehab expenses to be written off over seven years and less, whereas the previous treatment would have allowed them to be written off over twenty-five years and more. Despite the modest income that many such properties produce, *Goyer*-type treatment is nevertheless preferable (in the majority of cases) to the previous approach. Presumably some proprietors would have preferred to capitalize the investment and claim depreciation on it instead, but they are expected to represent only a fairly modest minority.

2.6 CONCLUSION

The *Goyer* case may significantly affect the "bottom line" on thousands of rehab projects in Ontario. It eases the pressure on some provincial governments which were considering unilateral income tax measures in heritage rehab. However, that subject is

probably not dormant. First, the *Goyer* case has certain negative implications for heritage buildings in terms of substitution of materials. Second, it addresses the entirety of the investment building stock, not specifically "heritage." Third, its impact may be curtailed if Revenue Canada fails to apply it to developers, particularly if that failure is not overturned by any future test cases in the courts.

Further, the *Goyer* case has exemplified the difficulties of communication in this technical area. Remarkably few interested parties have had access to reliable advice on the new tax treatment of their projects. That suggests a useful "clearing-house" role for heritage authorities. That subject is addressed in sections 6.4.2-3.

3 PROPERTY TAX TREATMENT

3.1 THREATS TO DESIGNATION EMERGING FROM THE COURTS

The concept of municipalities offering financial compensation (as a quid pro quo) in order to obtain heritage control through designation has aroused controversy in many parts of Canada. Although the concept of "compensation" in this field has long been viewed as unadministrable,[33] some provinces have insisted that municipalities "compensate" owners of municipally designated properties. Alberta legislation clearly imposes such an obligation.[34] In Manitoba, the Heritage Resources Act appears to trigger the same domino effect (when read in conjunction with the Expropriation Act), at least for municipalities outside Winnipeg. The issue in British Columbia is equally problematic.

Canadian municipalities are reluctant to forgo cash, particularly when they neither obtain title to the property in return nor see any restoration activity that would be visible to ratepayers. One city solicitor in Alberta summarized the situation: "We would recommend that the municipality never designate. If the municipality wishes to preserve a building, then it might as well buy it. Why pay money for designation without obtaining title to the property?"[35] Accordingly, the obligation to compensate has rendered such legislation a dead letter in many of the provinces that required it.

Although a statutory obligation to "compensate" may deter municipal action, it is not the only possible deterrent. Designation may precipitate a reduction in value which is then reflected in lower municipal taxes. That has happened in Canada.

Municipal taxation in Canada proceeds in two steps. The first is an assessment of land, along with "improvements" (notably buildings) thereon. That assessment, in Ontario, is usually required to be based on market value or a certain proportion of market value. The second step is to impose a tax, calculated as a fixed percentage of that assessment. That percentage is sometimes called the mill rate. That explains why the assessment stage is so important for the computation of municipal tax. However, although the tax is destined for municipal coffers, the system is devised by the province and the assessment process is governed by the provincial Ministry of Revenue.

Municipal taxation poses difficult questions concerning permanent heritage designations. Market-value assessment is usually based on what assessors consider "the highest and best use" of land. If, in the appraiser's view, the land can accommodate a ten-storey building in the immediate future, then that will be reflected in the attributed value. If the land has been heritage-designated, and that designation merely postpones redevelopment for a short time, then the "highest and best use" will (in the view of the appraiser) probably remain a ten-storey building, because the relevant legislation would eventually allow that. The situation changes, however, if heritage designation

permanently protects the existing building. From a juridical standpoint, any development beyond the existing envelope (and sometimes even within) would be subject to government veto, and the "highest and best use" is no longer redevelopment.

The implications for municipal finance are obvious. It is inconsistent to tax an individual as if his/her property has redevelopment potential and yet to deny the owner that potential.

One of the first legal battles over this issue was fought by the Vancouver Club. The club is a three-storey building in a high-rise area; for many years, market forces and zoning in Vancouver created a temptation to redevelop the property for high-rise use. The club was then designated under provincial heritage legislation which protected buildings permanently; the building could not be altered, demolished, or redeveloped without governmental consent. The city's tax authorities, however, continued to tax the land based on an appraisal predicated on high-rise redevelopment. The club appealed, arguing that since it had been designated, the value of the land should be predicated upon a "highest and best use" of three storeys. That argument was successful before the city's Assessment Appeal Board."

A more definitive statement is found in *Communauté urbaine de Montréal v. Baystate Corp.*" In that case, the Quebec Provincial Court heard an appeal from the Quebec Assessment Review Board. The board had studied a property composed of protected vacant land within five hundred feet of a designated building. No development was permitted without ministerial approval, but such approval was routine. The board reduced the assessed value of the land from $355,000 to $2. On appeal, the Provincial Court said that, in view of the government's veto (however theoretical), the "highest and best use" of the land should be equated with "current use," but it refused to intervene in the board's assessment. The Provincial Court's decision was upheld by the Court of Appeal.

Admittedly, that argument cannot be made fully in Ontario ... yet. Since the Ontario Heritage Act does indeed allow a vested right to demolition and replacement of buildings (upon the expiry of certain delays), no Ontario court can rule that the legal "highest and best use" is current use instead of the use provided in the zoning by-law. However, that situation would change if Ontario were to introduce permanent designation, thereby falling squarely into the same category as other provinces and becoming exposed to the same argument as the one that prevailed in the *Baystate* and *Vancouver Club* cases.

If precedents like those two cases are adopted generally by courts, authorities will be obliged to reduce municipal taxes on every heritage-designated property whose building is smaller than what the "highest and best use" would otherwise allow. In some cases, the difference may be negligible (e.g. in communities where market demand for space does not radically exceed the

volume of existing buildings). In other communities, however, the very threat of a tax reduction alone may deter the municipality from designating heritage property. In short, the courts have (in these limited cases) introduced a kind of tax measure that is not necessarily in the format best suited for the needs of Ontario's heritage resources.

Under such circumstances, authorities should perhaps establish a tax scheme on their own terms (e.g. to encourage rehabilitation) before an alternative scheme is imposed by the courts. In other words, there is a strong argument for creation of a system of municipal tax measures for rehabilitation, if only to pre-empt some less favourable tax changes. Again, there are some fortuitous opportunities at hand, as explained in the next section.

3.2 RESPONSES

The current system of municipal taxation provides a disincentive for all rehabilitation (or other development): any rehab may cause an increase in assessment, and hence in municipal taxation. Various statutes have attempted to minimize the impact of this rule on new construction. However, no province has enacted legislation that clearly provides corresponding treatment for heritage buildings.

3.2.1 PROPERTY TAX FREEZES

The same challenge exists in the United States, but there a wide range of property-tax measures encourage rehab, instead of discouraging it.[38] In Canada, tax measures have been introduced in municipalities large[39] and small.[40] The most successful technique in North America is unquestionably the so-called moratorium technique[41] which responds to an existing disincentive for rehab. Under the status quo, a rehab project usually leads to a substantial increase in real estate assessment and thus in property taxes. The moratorium merely defers tax increases for a certain time.

This technique, along with the others used in the United States, can be applied in one of two formats. There are two major steps in collecting municipal taxes: assessment of property and collection of taxes according to a prescribed formula. One can adjust the assessment and/or change the system for collecting taxes. The former approach is undesirable; Ontario's experience demonstrates that departure from true-market-value assessment produces almost limitless complications and it becomes awkward and difficult to return to that system.

This study therefore focuses on the second technique, adjusting the collection system. For any such measure, specific statutory authority is desirable.[42] Most provinces allow municipalities to provide tax incentives for other endeavours; some specifically allow municipalities to grant "tax relief" to

heritage sites. However, these statutory references have not stopped Canadian judges from disallowing incentives for heritage resources, and they do not necessarily authorize the municipality to adjust the assessments per se. In 1979, the B.C. Supreme Court looked at the comparable B.C. legislation which allowed municipalities to grant "tax relief" for owners of designated properties. It held that this phrase does not confer the "power given to alter or fix assessments." The assessment process, despite the heritage legislation, was still under "the jurisdiction given the Assessment Authority of B.C. to administer a system of land assessment in the Province."[43]

In Alberta, which apparently authorizes municipalities to grant "tax relief" to heritage properties, a municipal solicitor issued the following opinion: "[The municipality] would be open to legal challenge if Council adopted this policy in its present form ... We would obviously be walking a very fine line here, and it is difficult to predict with confidence that the Courts would uphold any such policy, irregardless [sic] of the wording."[44] The expression "tax relief" was sufficiently vague that it would not override the incredibly detailed and specific instructions in assessment and tax collection legislation. Since the latter was more specific, and since (in cases of conflict) "the specific overrules the general," the "tax relief" provisions would be ineffectual. In short, specific statutory authority is the path of caution.

Canadian municipalities that have successfully introduced a moratorium have solved the problem simply. Some good examples are Edmonton, Alberta; Perth, Ontario; and Yellowknife, Northwest Territories. Provincial or territorial governments empower those municipalities to give grants. Those cities have simply adopted by-laws making the grant that they will provide to the owner of heritage properties exactly equal to the increase in taxes stemming from the rehab project.

3.3 VALUE-ADDED FACTORS (VAFs)

The urgency of taking action on property tax freezes is increased by recent developments in the assessment profession. These are embodied in the growing reference to "value-added factors" (VAFs).

In some parts of Ontario, appraisal professionals have concluded that since rehab of investment properties is invariably done with a view to a return on investment, one may assume that the marginal value of improvements exceeds their marginal cost. For these assessors, the question is not whether there is an increment between marginal value and marginal cost, but how much.

In fact, a supposedly scientific practice has developed at the regional offices of Ontario's Ministry of Revenue, whereby tax assessors divide cities into sectors and then assign an average value, representing the supposed profitability of rehab in that

sector, i.e. the increment of marginal taxable value over marginal cost. This is the VAF, and it is taking the profession by storm. This writer's office is in a sector with a VAF of 1.75; assessors assume that any rehab done in this sector will increase market value (for assessment purposes) at a rate 1.75 times that of actual expenditure of funds. Therefore, for an investment of $100,000 in rehab of a building, assessment will increase by $175,000.

This new presumed market value can be challenged before the assessment appeal authorities (i.e. the Ontario Municipal Board); but that is no easy task. Appraisers defend the practice by arguing that it is merely a systematic refinement of the "true" principles of market-value assessment. The private sector views it differently. Owners and developers are decrying this tendency as punitive in the extreme.

That tax practice, and the private sector's reaction to it, constitute a state of affairs that the heritage buildings of Ontario may not be able to afford. It certainly does not provide any solace to the real estate industry either, as the industry attempts to become more involved in the reno sector.

A system of moratoria on tax increases, as described earlier, would of course pre-empt the VAF problem. If no tax increase occurs until several years later, then the resulting saving more than compensates for the rise in taxes created by an increase in assessment that is greater than the investment itself.

3.4 CONCLUSION

To recap, two major and urgent goals militate in favour of statutory action on property taxes:

- to prevent municipalities from being penalized (by the courts) for their designation initiatives; and
- to prevent owners and developers from being penalized (by appraisers) for heritage-oriented investments.

Unless Ontario takes action in this area, the long-term consequences could be problematic. However, by simply following the precedent of other jurisdictions (e.g. via a moratorium on tax increases), Ontario may significantly improve the prospects for its heritage buildings. Such initiatives could focus on designated buildings and districts (as in the United States), in the form of an economic quid pro quo for heritage control.

4 INVENTORY OF ECONOMIC MEASURES

4.1 BACKGROUND

Every government in Canada has joined most governments in the Western world in search of economic strategies to capitalize on heritage property. Motives have varied. Some governments in Canada (and elsewhere) are responding to the demand in the World Heritage Convention "to take the appropriate legal ... technical, administrative and financial measures necessary for the ... rehabilitation of this heritage."[1] Others believe that such action will be good for their gross provincial product.[2] Still others argue that by balancing "carrots and sticks," one is creating a more broadly based system[3] that might even reduce the risk of legislation being struck down by the courts, if such heritage legislation is ever challenged under the Charter of Rights and Freedoms.[4] Although a serious Charter challenge is unlikely, a fully balanced system of carrots and sticks will probably reduce even further the likelihood of such challenges.

The problem is money. Its use as an incentive has been falling out of favour. The debate over tax incentives has been overshadowed by the continent-wide move toward tax simplification. Furthermore, the industry's distaste for "incentives" was described earlier. In any event, both financial and tax incentives cost money to hard-pressed government treasuries. Accordingly, there has been increasing attention to assistance that benefits owners at little cost to the treasury.

There are limits, of course. One American textbook identified, among municipal tax measures alone, no less than forty-three formats, which required the entire book to describe.[5] To do justice to the entire subject would require volumes. It is nevertheless possible to indicate the main features. As mentioned earlier, these measures can be classified according to jurisdiction (i.e. provincial, joint provincial-municipal, or municipal). They can also be grouped according to type (tax, regulatory, or supportive). The chart provides an overview of the types of measures conceivable in each category.

4.2 POSSIBLE TAX, REGULATORY, AND SUPPORTIVE MEASURES

Category	Provincial (Chapter 5)	Provincial-Municipal (Chapter 6)	Municipal (Chapter 7)
Tax measures	• Sales tax waivers • Tourism MURBs (multiple-unit residential buildings)	• Property tax freezes	• Tax increment financing
Regulatory measures	• See "Provincial-Municipal" column	• Code flexibility • Streamlining of approval procedures	• Transfer of development rights (TDR) • Zoning incentives • Preferential hours of opening • Preferential approvals • Approaches to condemned buildings
Supportive measures	• Development corporations • Equi-bonds • Cannie Maes • Risk-sharing loans • Access to RRSP funds • Access to venture capital • Hybrid development corporations • Integration with existing government development programs • Preferential signage • Professional education • Certification programs • Warranties • Computerized Ontario Investment Network (COIN)	• The public-sector market • Professional information services • Assistance in marketing heritage properties and integration with COIN • Managed workspaces • Building preservation trusts and low-interest loans • Co-operative approaches to insurance • Integration with government housing programs	• Policies targeting joint action by owners

5 PROVINCIAL MEASURES

5.1 TAX MEASURES

5.1.1 SALES TAX WAIVERS

A major category of provincial taxation is sales tax. The government of Nova Scotia waives provincial sales taxes on the approved restoration of designated heritage properties. Since the typical restoration project tends to be labour-intensive rather than capital-intensive, most observers expected the cost to be modest. That prediction was based on the provincial government's study *Economic Impacts of Renovation Activity Associated with Restoration of Heritage Properties in Nova Scotia:*[36]

- For small renovation projects employing contract labour, one dollar of sales tax revenue forgone will be offset by one dollar of provincial tax revenue.
- For small renovation projects using non-market labour, one dollar of sales tax revenue forgone will not yield any compensating provincial tax revenue.
- For contractor renovation projects sufficiently large to generate full multiplier (spinoff) effects, one dollar of sales tax revenue forgone will realize $2.40 in compensating provincial revenues."

There is a dearth of North American literature on this subject. According to the National Trust for Historic Preservation, in Washington, D.C., perhaps two U.S. states have a comparable tax provision. In the case of a close counterpart to sales taxes - namely the European value-added taxes, or "VATs" - there is extensive experience concerning total or partial waivers of tax on projects pertaining to rehab of designated heritage properties."[37]

Recent statistics on Nova Scotia's program, which covers rehab projects approved under the province's Heritage Property Act, are unavailable. However, government heritage officials have expressed satisfaction concerning this program.

In the Ontario Heritage Policy Review, there have already been briefs presented calling on Ontario to undertake a similar initiative.

5.1.2 TOURISM HURDS

As a general rule, losses from one revenue-producing activity cannot be deducted against income from an entirely different revenue-producing activity. For example, losses on real estate investments cannot usually be deducted against professional income: they can be deducted only against other real estate revenue.

There are exceptions. The Income Tax Act (Canada) provides some such "shelters." The consummate example was seen in the 1970s in the case of multiple-unit residential buildings (MURBs). For example, a doctor could invest in a town-house development; the deal could be structured to produce significant losses in the first years (e.g. with the help of "soft costs" and immediate claims of depreciation), and these "losses" could then be deducted from the investor's medical income. Needless to say, tax shelters were tremendously popular among certain categories of investors and induced billions of dollars of investment in that category of property.

By the late 1970s, this approach was losing favour at Finance Canada. During the 1980s, a series of changes in the Income Tax Act phased out this tax shelter; however, there have been recent influential calls for the concept to be revived ... for the tourism sector. In June 1987, a federal-provincial meeting of tourism ministers established a working group (reporting to tourism ministers) on "Financing Instruments and Concepts for Canadian Tourism Product Development." The "Tourism Working Group" submitted its report in March 1988." It recommended that tourism operators be allowed to apply losses (including those resulting from claims of depreciation) against other income.

There are two connections between this proposal and the interests of the heritage community. First, many heritage-oriented investments have a direct tourism component and would benefit directly from such an approach. Second, the heritage community itself recommended a decade ago that the MURB concept be applied overtly and directly to heritage-oriented investments.

A report commissioned in 1979 by the then federal minister responsible for heritage matters recommended that investments in designated heritage properties:

- be specifically foreseen in the Income Tax Act;
- enjoy a reasonably high level of allowable tax-deductible depreciation; and
- enjoy MURB-type treatment which would allow losses to be applied against other categories of income.

At a public forum in May 1979, however, spokespersons for Finance Canada expressed profound scepticism over such an approach; developments during the 1980s (including the June 1987 White Paper on Tax Reform) suggest that such scepticism may not have decreased but rather increased. Even the tone of the Tourism Working Group's report suggests that it was aware of the political difficulty inherent in resurrecting this kind of approach. If, however, the notion of tourism MURBs appears to be overcoming the obstacles in its path, then (at that point) there may be serious interest in resurrecting the concept of specifying investments in heritage-designated properties as being eligible for MURB-type treatment.

5.2 REGULATORY MEASURES

Until recently, some regulatory measures affecting the economic viability of heritage buildings were of exclusively provincial jurisdiction. One example was control of Sunday shopping in "tourism zones." However, most regulatory measures that could be undertaken today in this area have a strong provincial-municipal overlap. They are therefore described in this study, at section 6.3.

5.3 SUPPORTIVE MEASURES

A number of measures may improve prospects for investment in the heritage building stock. Eleven types of measures involving a purely provincial initiative are described in this section.

5.3.1 DEVELOPMENT CORPORATIONS

In several provinces, governments have encouraged creation of local development corporations specifically targeting heritage rehab. A development corporation is merely a corporation, either for-profit (i.e. a business corporation) or non-profit, which is in the business of doing a certain kind of development. Those specializing in heritage properties attempt to model themselves on real estate developers, but with a heritage bias.

SIMPA, in Montreal, is an example in Quebec of a multi-million-dollar corporation investing in heritage buildings. Approximately thirty comparable entities have been established with the assistance of the Government of Ontario under the name "community heritage funds," to invest in heritage buildings across this province, but at a much smaller level. They are structured as non-profit corporations with volunteer boards. Working capital tends to be below $200,000 for each.

One such corporation, Historic Ottawa Development Inc. (HODI), has expressed its views to the Ontario government on the challenges faced by these entities. According to HODI, its $130,000 in capital is insufficient to do a project on its own. Although it could increase its capital by borrowing, the volunteer board is reluctant to take such a risk when there are no full-time personnel to supervise it. The only remaining option (to capitalize on its money) was for HODI to seek partnerships with other developers. That, too, was difficult because HODI's shortage of capital caused a credibility problem with other developers. Many entrepreneurs suspected that any government-backed entity with the word "historic" in its title would impose more red tape on the project than its financial participation was worth.

HODI therefore recommended to Ontario's Ministry of Culture and Communications that a province-wide development corporation be created. This larger entity would have at its disposal substantially more capital on which the thirty smaller development corporations could draw. The latter would presumably decide about the merits of the investment, interest rates, and so on. The centralized corporation could also make expertise available to them in order to improve the overall quality of business decisions.

Perhaps of equal importance was a corollary effect. HODI also argued that a large provincial development corporation could take advantage of opportunities not currently being capitalized on. One notable example is the disposition of federal properties. Under existing rules, a federal agency that has surplus property is usually supposed to offer it to provincial or municipal authorities before selling it to the private sector. A provincial development corporation could conceivably take advantage of such offers, which occur more frequently during these days of privatization.

HODI's proposals are currently under consideration.

HODI also suggested that a provincial corporation could use some innovative techniques. Those are further described below in sections 5.3.2-5.

5.3.2 EQUI-BONDS, CANNIE MAES, AND RISK-SHARING LOANS

In the case of a development corporation, there are two major questions to be addressed:

- 1. How is it mandated to spend its funds?
- 2. How does it raise its capital?

Question 1 can also be asked of any government agency involved in heritage investment.

Development corporations are usually thought of as participating in direct investment, i.e. acquiring and improving properties. However, they may prefer to play an indirect role, such as becoming a minority shareholder or providing loan capital via mortgages, bonds, securities, or other such transactions.

The purchase of equity (i.e. shares) is mostly self-explanatory; however, some additional features may make such investments more attractive. Venture capital provisions, for example, are described below, in section 5.3.4.

Loan capital would also appear self-explanatory, except that new vehicles are now being developed to facilitate these investments, including equi-bonds, mortgage-backed securities ("Cannie Maes"), and risk-sharing loans, all three of which have been analysed by the Tourism Working Group.

First, equi-bonds,[44] if approved by the relevant governments, would entail establishment of a program that would require administrative participation by government, but no significant financial involvement. The Working Group had described such a system for the tourism sector; but it could also be applied to the heritage sector. Under the plan, investment in a given enterprise would be divided into two parts: equity (i.e. shares) and a bond. The bond component, however, would be deposited not directly in the enterprise but rather with the government. The bond would stay on deposit for perhaps five years and accumulate tax-deferred interest. At the end of the five years, the investor could either keep the shares (at which time the interest on the bond would become taxable, according to a specified formula) or relinquish them (whereupon the bond could be cashed in with interest tax-free).

The above appears a fairly complicated formula.[45] However, it may facilitate raising of capital in a way that is specifically designed to reduce the 100-per-cent element of risk inherent in many tourism-type (and many heritage) operations. "The incentive is targeted primarily at relatives and friends whom an entrepreneur might be hesitant to approach for capital that is 100% at risk. However, it could also be effective for other individuals who can be encouraged to shift a portion of their fixed income portfolio to small business equity if there is sufficient risk offset."[46] Despite the complexity of the equi-bond proposal and the necessity to negotiate its tax implications and administrative provisions with various levels of government, this initiative warrants exploration.

Second, mortgage-backed securities[47] are a loan-guarantee program, with both public-sector and private-sector components. A Crown agency would guarantee principal and interest payments of qualifying loans (for an appropriate fee) or be a direct lender. It would, in turn, issue its own bonds or certificates, which would be traded on the securities market. The agency would act as an intermediary between investors and entrepreneurs.

The Working Group modelled this proposal on General Motors Acceptance Corporation (GMAC), which recently "raised over $7 Billion of securitized car loans in less than a year,"[48] and on National Housing Act mortgage-backed securities. The GMAC program is credited with allowing "consumers saving approximately 4 per cent on car loans vs traditional financing sources."[49] The investment community has nicknamed such securities "Cannie Maes."

The Working Group concluded that "consultants have indicated that for every dollar invested by the government ..., $10-50 of capital can be leveraged through the securities markets."[50] It accordingly recommended further exploration.

Third, risk-sharing loans,[51] instead of being repaid before other financing, are repaid afterward. The concept was introduced by the Quebec government in the summer of 1987 "to facilitate

investment for manufacturing firms, and has already been adapted to meet the special needs of tourist firms whose returns are usually long term."[42]

In Quebec, the government makes the loan at market rates; the loan is unsecured. It covers up to 35 per cent of the project (45 per cent for downhill-ski projects). It is repaid over a maximum of thirteen years, "according to a flexible schedule which takes into consideration the revenue generated by the project and the obligation to repay other loans."[43] Furthermore, the loan "could allow for a moratorium of up to three years on the repayment of principal and interest."

The repayment schedule is based on a specified formula which incorporates the net worth of the company at any given time. "In practice, this means payment to the government, when it decides so, of a part of the increase in the net worth of the firm attributable to the project. Thus, the government shares in any proceeds of the project." The government can convert the loan to an equity position (i.e. shares).

The Working Group observes that the proposed program "is meant to be self-financing, which eases the government's deficit. The formula is in line with the requirements of free trade and free competition. The government that shares in the risk also shares in any profits."

These three exercises all warrant monitoring, with a view to integrating heritage-oriented projects with them if they are as successful as predicted.

5.3.3 ACCESS TO RRSP FUNDS

The development corporations described in section 5.3.1 may be in large communities, small communities, or even province-wide; but they all need capital. The non-profit corporations generally rely on public funds; but during times of budgetary restraint, further attention must be devoted to alternative sources of funding. That is where the following proposal may play a role.

As soon as one contemplates use of private capital other than loans or bonds, one is usually referring to a for-profit business corporation instead of a non-profit corporation. It is the prospect of profit (income or capital gain) that induces the investment. There are, however, various ways of attracting that investment.

Last year, Canadians invested about $7.5 billion in Registered Retirement Savings Plans (RRSPs). Can some of that capital be directed into heritage rehab at the regional level - or provincially or locally? Section 5.3.5 presents a specific example of a corporation using RRSP funds to rehabilitate older buildings on a province-wide basis. The following are the basic rules.

Under the Income Tax Act (Canada), the trustee of an RRSP can invest RRSP funds in a variety of investments. The trustee can be directed either by an institution or by the plan's owner (in the case of a self-administered RRSP). Those investments include:

- bonds or mortgages guaranteed by Canada, a province, or a municipality;
- shares on a prescribed stock exchange;
- investment contracts specifically approved by the Canadian government;
- other investments approved by regulation.

Specially approved investments can include "public corporations" such as those that have elected to be a public corporation or that have been designated as such by the minister of national revenue. The prescribed conditions include:

- It is resident in Canada.
- A class of its shares is qualified for distribution to the public.
- There are, exclusive of insiders, no fewer than 150 shareholders, where such shares are equity shares, or 300 shareholders, where shares are other than equity shares.
- Each of the minimum number of persons holding shares holds at least one block of shares of that class and holds shares with an aggregate fair market value of not less than $500.
- Insiders of the corporation, as defined under the Canada Corporations Act, do not hold more than 80 per cent of the issued and outstanding shares of that class.

Insiders include any director or officer of a corporation and any person who owns or exercises control or direction over voting shares carrying more than 10 per cent of the voting rights of all voting shares of that corporation.

Obviously, in order to use this technique, one must have created a company in which to invest. The company should make a sufficient return on investment at least to meet its obligations to its shareholders or bondholders, who expect a return on their RRSP investment.

Should provincial, regional, or local corporations be created to channel investments into heritage property? Such corporations would seek private capital (via shares or bonds) and would invest in projects with a heritage character. A corporation would need to be run according to sound business principles, in order to meet its business obligations.

The concept appears to have potential popular appeal. There may be good market-driven reasons to create institutions that are committed to recycling RRSP money in the heritage of the locality, the region, or the province. There may be strong local interest in investing in an institution that will use those funds to improve the area.

5.3.4 ACCESS TO VENTURE CAPITAL

Most provinces have a "venture capital" program, which subsidizes small corporations that invest in other companies located in certain key sectors of the economy. Ontario's Ministry of Revenue, for example, provides a tax-free grant of 25-30 per cent to investors who put their money in small business development corporations, which in turn invest their money in other enterprises in manufacturing, publishing, research and development, or tourism.

If heritage projects were eligible for venture capital, that would mean a possible 30-per-cent immediate return for interested investors, subject to certain conditions. There is no immediate policy reason why this should not be done forthwith.

Let us recap at this point. Development corporations for heritage buildings can work, but they need a certain "critical mass" or else they flounder. One way to "jump-start" their equity-raising potential would be to give them access to RRSPs. Another means would be to make them eligible for venture capital. Each of these methods is worthy of consideration in its own right.

5.3.5 HYBRID DEVELOPMENT CORPORATIONS

When access to RRSPs and eligibility for venture capital have been combined, the impact on heritage work has been surprising.

The foremost example of this phenomenon is the Granite Group, a group of companies based in Toronto, which combined both features. The description that follows focuses on the raising of equity during several years in the mid-1980s. That period is now over, because Granite's shares were fully subscribed and the offering therefore ended. Nonetheless, the technique itself is still of considerable interest.

The Granite companies are eligible for RRSP investment. They are also small business development corporations, whereby 30 per cent of investments in them is rebated to the investor via a tax-free grant from Ontario's Ministry of Revenue. The marketing technique used by Granite to raise equity capital emphasized the following consequences. If an investor put his/her $7,500 annual RRSP contribution into Granite shares:

- The $7,500 RRSP contribution was tax-deductible. For a person in a 40-per-cent marginal tax bracket, the after-tax cost was $4,500.

- The $7,500 investment in Granite gave rise to a 30-per-cent tax-free grant, i.e. $2,250.
- The net cost was therefore $2,250, to obtain shares with a face value of $7,500.

Since Granite invests exclusively in real estate and never borrows (i.e. it pays 100-per-cent cash for everything), it claimed that the risk factor for the long term was minimal.

That marketing strategy raised $42 million in equity within five years - an impressive performance, particularly because so many corporations (especially new ones) involved in real estate speculation and development are greeted with public scepticism and occasional controversies over financial practices.

The Granite Group has used the money for several purchases of a heritage nature, including four old resort hotels and conversion of a large heritage house (with infill) to a hotel in Ottawa.

The Granite example raises a further question. What would happen if the Government of Ontario established one or more medium-sized development companies to invest in heritage property for profit? Furthermore, what would happen if that company were entitled to seek not only RRSP funds but also venture capital support? Although it is too early to make predictions concerning those questions, this precedent suggests that such an avenue might have multi-million-dollar potential for the heritage buildings of Ontario.

5.3.6 INTEGRATION WITH EXISTING GOVERNMENT DEVELOPMENT PROGRAMS

There are existing government programs to induce investment in a variety of areas. The areas most closely related to heritage are housing (described in section 6.4.7), downtown revitalization, and tourism.

Programs targeting downtown revitalization, notably those relating to business improvement areas (BIAs), represent probably the provincial government's strongest intervention in non-residential renovation. This initiative has grown to the point that there is an Ontario BIA Association (OBIAA). Some downtown revitalization projects have had a strong heritage component; others have had decidedly negative effects on the heritage resources of certain communities. The Main Street Program of the Heritage Canada Foundation, which is publicly funded but non-governmental, has attempted to walk a fine line. It will vigorously pursue the "heritage look" if local property owners and business people are so disposed, but it is prepared to assist downtown revitalization projects that are aesthetically neutral while biding its time awaiting a more heritage-oriented opportunity.

In view of the importance of downtown revitalization projects to the heritage resources of Ontario, this entire sphere of activity (and the funds allocated to it) warrant consideration. Furthermore, it can benefit from infusions of expertise, a topic addressed at section 6.4.2.

Of even greater monetary significance is the topic of Tourism Development Programs. For example, since 1984 Ontario's Ministry of Tourism and Recreation has guaranteed and subsidized loans (available via Ontario Development Corporations - ODCs) totalling some $25 million per year on average. ODCs are public-sector corporations established across the province to foster development via programs from a variety of ministries. Between 1984 and late 1987, they had triggered a total investment of over $200 million in tourist facilities. Interest subsidies represent about 20 per cent of the loan amount on a net-present-value basis. The default rate has been less than 2 per cent, and the total cost to government has been quite modest. The Tourism Working Group concluded: "There was unanimous agreement that the time period for testing of this instrument of Ontario has been long enough to prove it an unqualified winner. The key to its success was attributed to thorough project evaluation by government. The Group had no hesitation in recommending it for implementation by [jurisdictions and agencies] where a similar funding vehicle is not presently in place."[4]

There are merits in considering adoption of a program modelled on that of the Ministry of Tourism and Recreation or, alternatively, merging of heritage-oriented projects into existing government programs in the tourism sector and addition of heritage-oriented projects to the targets of the ODCs.

5.3.7 PREFERENTIAL SIGNAGE

An official highway sign can be worth a great deal to the business of an entrepreneur. For example, Quebec recently introduced a policy whereby various attractions (from heritage sites to sugar bushes) are indicated on freeways of the province. The signs are standard government issue and cost only a few dollars, but they provide a very significant benefit for operators.

In Ontario, there are comparable examples. Highway 401, between Toronto and Montreal, has government-issue signs for two forts, one zoo, Upper Canada Village, and Gananoque's boat tours. The question is this: in such a tourism-sensitive province, why are these the only attractions to benefit from such largesse? The answer is that highway officials refuse further signs because of the reputed fear of clutter and of distracting drivers. The tourism industry has argued, in response, that the occasional government-issue sign does not create visual clutter, nor is there any reliable evidence that it increases the rate of accidents. When one views the signage in Quebec, it is difficult to picture how this could be accused either of "clutter" or of constituting a highway risk.

A policy of promoting government signage for "heritage sites" (wherever practical), in the case of designated properties used for commercial purposes, would do the same for Ontario as Quebec has done with sugar bushes. This is a very inexpensive technique, with interesting economic prospects.

5.3.8 PROFESSIONAL EDUCATION

One of the major threats to heritage buildings in Ontario is the well-intentioned but unqualified renovator. This problem is so serious that until recently the reno sector provoked the highest number of complaints of any industry in Ontario except car repairs. Obviously, this can have a dampening effect on the market.

A number of responses have been under intense discussion in the industry - most notably, development of professional education campaigns directed at renovators. Canada Mortgage and Housing Corporation (CMHC) is organizing its educational program for renovators, in close consultation with the Canadian Home Builders' Association (CHBA).

Initially, the program is dealing less with structural niceties than with basic business techniques. For an industry in which (according to the CHBA's rule-of-thumb) over 80 per cent of firms go bankrupt in the first year, the highest priority is business acumen, along with proper approaches to salesmanship, bidding, and contracting.

That emphasis is not merely self-serving; consumers have no recourse against renovators if the firm they hired has gone bankrupt. This profound instability must be corrected, if there is to be long-term growth in consumers' confidence and growth in the market accordingly.

The industry is confident that this approach is making headway. In an article written for *Building Renovation* magazine, Laverne Brubacher, then president of the Canadian Renovators' Council of the CHBA, was quoted as saying: "'the industry no longer is equated with auto-repair shops when it comes to consumer complaints received by [the Ministry of Consumer and Commercial Relations].' He suggested the intense consumer education [to assist consumers in selecting more competent renovators] put into place last year in cooperation with CMHC, has paid off. There are now eight other industries that have more consumer complaints."[45]

Those concerned about the future of heritage buildings have a direct interest in participating in these efforts, which have emerged quite independently to upgrade the skills of renovation practitioners. However, the primary interest of practitioners is not necessarily heritage: it may be energy retention, efficiency, life-style changes (e.g. kitchen and bathroom remodelling), and so on. Some practitioners believe that

"heritage" concerns may run precisely counter to the assignments given by their clients. Nevertheless, these practitioners are the hands-on participants in an industry affecting tens of thousands of Ontario buildings every year, and their day-to-day performance is crucial.

5.3.9 CERTIFICATION PROGRAMS

The desire to develop consumer confidence has led the renovation industry to examine other ways to improve its professionalism. The industry has declared that it would be in favour of a certification program and better enforcement of bond coverage on jobs.[46] That approach has already been promoted by the two major American renovation organizations, namely the Remodellers Council of the National Association of Home Builders (NAHB) and the National Association of the Remodelling Institute (NARI). In each case, diplomas are given after training programs, and those diplomas obviously assist in sales.

5.3.10 WARRANTIES

Some years ago, the Quebec government introduced Canada's first system of warranties for renovation work. This was again a technique to increase consumer confidence and hence expand markets.

The issue of warranties is being studied at several levels. At the federal level, the minister of housing, Alan Redway, was quoted as saying, "There is a dire need to fulfil contractual obligations on the part of the building industry and renovation contractors." He singled out renovation and said that his officials were "looking at a warranty program here." His comment is obviously based on a study paper done by CMHC that indicated that consumers are willing to pay up to 2 per cent more for renovation activities that fall under a warranty plan.[47]

The concept, however, is not easy to deal with. In the view of one observer, introduction of an obligatory warranty program in Quebec meant that "a huge black market developed immediately ... This has abated, somewhat, with more members now involved in the program but, at the same time, it has driven the 'fly-by-night' black market renovators deeper underground. The result: they become more difficult to identify and control."[48] "Fly-by-nighters" are an ongoing sore point for legitimate renovation contractors. Not only do they do shoddy work and disappear without a trace (thereby giving the entire industry a bad name), but they also cheat on taxes and underbid their legitimate competition.

Legitimate representatives of the industry are therefore interested in limiting the harm caused by unscrupulous or negligent contractors; but the industry is currently divided on the effectiveness of warranties.

In the meantime, legislators in Ontario do not yet have a policy on warranties, but the Ministry of Consumer and Commercial Relations is preparing a Legislative Review Project Report that recommends a wide range of additional regulations and restrictions on the home renovation industry in Ontario." The Toronto Home Builders' Association and the Ontario Home Builders' Association would have preferred a joint industry-government task force. The industry does not want regulation for regulation's sake but is anxious to ensure that proposed governmental measures are indeed targeted at problem areas in the industry.

Again, this is an issue whose sheer scope demands close attention from the heritage community. It may affect the way that the entire industry approaches its day-to-day tasks.

5.3.11 BUSINESS IMMIGRATION PROGRAM

Canada's federal government has a Business Immigration Program to attract foreign investors to immigrate to this country. Individual provincial governments are able to modify the program to suit their particular needs; adjustments and modifications require federal approval." Ontario, for example, has clearly enunciated the conditions under which it wants the program to operate, and these conditions are generally followed.

The program contemplates two categories of immigrants: entrepreneurs and investors. In Ontario, applicants in the "entrepreneur" category are usually expected to establish a business that can employ at least five people. Although this category has some interest for heritage-oriented projects, the other (i.e. investor) category may be the focus of attention.

The investor category has the following terms:

> Applicants ... are required to make a minimum investment of $250,000 for a period of three or more years in an approved Canadian business venture. Investors are required to have a net worth of at least $500,000 and must also have a proven track record in business. Investors must demonstrate that proposed investments will provide economic benefits to Canada and that they will create or provide employment benefits to existing Canadian residents."
>
> The only costs associated with the Program are promotion and administration costs. Governments do not contribute financial incentives to potential investors in the form of tax credits, grants, low interest loans, etc. Investors and entrepreneurs are drawn to Canada by the appeal of the Canadian Visa."

Whether heritage-oriented projects could be specifically included among target investments under the program needs further exploration. Some real estate investments qualify because there is employment directly associated with them. One hotel in Ottawa, for example, has so qualified. However, more passive real estate investments (which do not imply creation of many

permanent jobs) are more difficult to have listed under the program.

Obviously, an eligible investment has a better chance of raising offshore capital than one that is not eligible. Furthermore, in view of the predilection of some societies to invest in real estate, an eligible real estate investment has a distinct advantage (for attracting capital from aspiring applicants for immigration under the program) vis-à-vis almost any other investment.

6 JOINT PROVINCIAL-MUNICIPAL MEASURES

6.1 INTRODUCTION

The present chapter addresses areas of overlap between the provincial government and municipalities. The overlap may stem from two sources. First, some of the following initiatives would need to be undertaken jointly - for example, initiatives requiring an amendment to enabling provincial legislation, followed by municipal administration. Alternatively, some of the following measures could be undertaken either by the provincial government or by municipalities.

6.2 TAX MEASURES

The topic of joint provincial-municipal initiatives in the tax field (namely property tax) has been addressed in chapter 3.

6.3 REGULATORY MEASURES

6.3.1 CODE FLEXIBILITY

Building codes specify safety standards that construction projects must meet. These codes are usually adopted by provincial governments, which use the National Building Code[7] as a model. In some cases, leeway to municipalities is allowed.

Rehabilitation ("rehab") projects are often required to meet standards comparable to new construction. In principle this is laudable, but when applied literally to buildings that may have originated with a design entirely different from current practice, the results can be extraordinarily (and unnecessa-ily) awkward.

The National Building Code specifically permits building inspectors to grant "equivalents": that is, to approve buildings that do not meet the wording of the code but are otherwise as safe as the code buildings. Inspectors, however, are reluctant to make such decisions, for, in some cases of fire, lawsuits could have been launched against the inspector.

The practical impact of this problem varies from one municipality to another. In some municipalities, building inspectors automatically refuse any project that does not comply textually with the National Building Code; in others, trade-offs are possible. The degree to which inspectors will exercise such discretion will vary.

In response, some jurisdictions allow the minister responsible for heritage to substitute an alternative set of standards on an ad hoc basis. This is the case in Manitoba, Saskatchewan, and Alberta. California had adopted a further approach, namely, an entire new code for the restoration of old buildings. Ontario has taken steps in a similar direction: the new Part XI of the Ontario Building Code is devoted to renovation and already

includes crucial provisions, such as the right to do renovation work in phases."[74] This change has been praised by practitioners who work with older buildings. Systematized use of equivalents can cut capital costs on a project, can save heritage features on a building that might be menaced by current code provisions, and can shorten the time for approvals, thereby reducing holding costs. Further code amendments are already under study in Ontario. As well, British Columbia currently is working on a version that will go beyond Ontario's Part XI.

6.3.2 STREAMLINING OF APPROVAL PROCEDURES

The next chapter (see section 7.2.4) contains a description of the methods and implications of reducing holding time, between the date of submission of an application for a permit on property and the date of issue of that permit. In some cases, that reduction (sometimes called "the cutting of red tape") may produce merely political advantages; in other cases, significant economic advantages may accrue. Section 7.2.4 describes how a municipality may wish to launch a "fast-tracked" system for approvals on heritage property. The following will describe some implications of that approach.

Any system of planning and building controls requires several steps in the approval process. For example, municipal officials must check all plans for compliance with zoning regulations and with building regulations such as the codes. That vetting process takes time. Where the property has been designated under the Ontario Heritage Act, an additional level of approvals is required, involving perhaps both the local architectural conservation advisory committee (LACAC) and the municipal council. It is not uncommon, therefore, to hear owners express concerns about "supplementary red tape" affecting heritage-designated property.

Municipalities may wish to respond to that concern. One way is to issue guidelines outlining, as clearly as possible, exactly what kinds of development are contemplated at the property. That may reduce the risk of owners coming forth with unacceptable proposals, which would merely be rejected and waste both parties' time.

Another method is for the municipality to express, by by-law in advance, exactly what kind of development is foreseen for that property. If a development proposal were judged to comply with the municipality's scenario, there would be no need for the application to return to municipal council, thereby saving time for the applicant and for the council and its staff. That approach was recently adopted in Yellowknife, Northwest Territories.

Still another method is to attempt to delegate to LACACs the right to approve routine matters.

Under existing legislation, it is not clear that either of the above two measures is legal in Ontario. These two possible methods therefore warrant further exploration.

6.4 SUPPORTIVE MEASURES

6.4.1 THE PUBLIC-SECTOR MARKET

Ontario has no formalized system that makes it easier to locate government services in heritage buildings than in other locations. Provincial and municipal governments may equally encourage use of heritage buildings. Although agencies like the Ontario Heritage Foundation may occupy a fine heritage building, this is the exception, not the rule. The amount of new construction going on to accommodate government services dwarfs the amount of government office space in Toronto's commercial heritage properties. The Ontario government is not even attempting to show the private sector, by example, how to capitalize on the older building stock and is thereby undermining the credibility of its messages about reusing heritage buildings.

In contrast, the U.S. government has been trying not only to make it easier for government agencies to locate in heritage buildings: it has been trying to make it obligatory. Under the U.S. Public Buildings Act" (as amended by the Public Buildings Cooperative Uses Act), governmental arrangements for public buildings must be preceded by a survey of all existing structures in the area that are of "historic, architectural or cultural significance" and that "would be suitable whether or not in need of repair, alteration, or addition."" The act applies to both leased property and purchased property." Comparable legislation is also found in American states." In fact, some states such as California and New York insist that government agencies look at heritage buildings to meet their needs even when these facilities are privately owned."

This type of measure creates a captive market for heritage buildings and also delivers a clear message to the rest of society: government takes heritage resources seriously. It is difficult to persuade the private sector that it should rehab and occupy heritage buildings if the government refuses to commit itself to the same course of action.

The U.S. legislation has not been an unqualified success. Its weakness is not in the concept but in the execution. It has been reported that it ran counter to the tastes of many senior civil servants", who have taken measures to circumvent it."

Despite that problem, this approach may warrant further exploration. For example, if laws like those in the United States had been in effect in Ontario, the government could have found itself rehabbing much of Toronto instead of locating its Heritage Branch in a high-rise.

The UNESCO World Heritage Convention includes the obligation, on member states, "to give heritage a function in the life of the community."[42] No Canadian province has gone as far as enacting legislation along those lines. In Manitoba, however, there appeared to be a policy commitment to locate government offices in heritage buildings.[43] It is not clear to what extent this has affected day-to-day practice. A comparable commitment is common in European capitals as well.

Scaled-down versions of this approach are also possible. For example, the recital in new legislation of the powers of the minister of culture and communications might include the assignment to advise other ministries of heritage properties available, and the minister would rely on moral suasion to persuade these bodies to use them. That assignment would require only a marginal investment of time, since the research would be done by real estate agents for the heritage properties in question, who would be feeding their information into the ministry for relay. That exercise would, incidentally, provide the ministry with a valuable window on that portion of the real estate industry.

6.4.2 PROFESSIONAL INFORMATION SERVICES

Assisting the private sector by offering professional information is not a new concept. It may be provided either by the province or by municipalities, sometimes by both. In section 5.3.6, there was mention of downtown revitalization programs and assistance to BIAs. The Heritage Canada Foundation's Main Street Program is the consummate example of a program focused exclusively on provision of expert advice.

Some provincial programs in other sectors of the economy are already quite elaborate. The Tourism Working Group describes, for example, a Management Advisory Service which assists:

> firms requiring advice or guidance in the financial, bookkeeping, marketing, technical or other functional areas of business. Confidentiality is assured. A particularly innovative project is the Inforeach Business Information and Library Service [maintaining] an extensive business library of some 3000 volumes and 250 periodicals. Business may access this data directly or through a mail service. This service is particularly targeted at providing businesses with the proper information to make business or technical decisions."[44]

Similar approaches can be considered in the context of heritage buildings. In theory, experts could be made available to advise renovators on the best ways of treating heritage properties. The experts could be on retainer or be volunteers.

The effect of such a service can be dramatic, and it is not confined to the architectural or structural niceties of the building. The most telling example is in St John's, Newfoundland.

That city has almost 1,500 buildings in its designated historic districts." Under the circumstances, one would have expected St John's to have been daunted by the prospect of establishing an architectural committee to advise on renovation proposals. However, the city not only did so, it developed an informal practice whereby the committee would not merely reject proposals for incongruous renovations but would produce a counterproposal.

This informal practice went even further: if the counterproposal were more expensive than the renovator's original idea, the city would make up the difference. The budget allocated for that purpose was only $25,000; some observers expected it to disappear in days. On the contrary, that budgetary allocation was discontinued after several years, because it had never been touched. In every instance of a counterproposal, the committee had produced a concept that would cost the same as or less than the original proposal.

The benefits of that approach extended well beyond the building stock affected. The goodwill generated between public and private sectors was of inestimable value. This kind of measure could be introduced at two levels, namely provincial and municipal.

This approach would function best if there were a centralized source of professional advice on which municipalities themselves could draw. Unfortunately, this does not exist even at the national level but has been the subject of some discussion among CHBA, CMHC, and the Association for Preservation Technology. There has been some concern that the National Research Council and its spin-off institutes have devoted all their attention to new construction, with little corresponding attention to the existing building stock. Any province that wishes to establish an information clearing-house for the industry is starting almost from the beginning.

However, unless Ontario (including municipal officials and property owners) has access to the best technological information in this area, both its heritage resources and its construction industry will be at a severe disadvantage. Establishment of such a visible and accessible corps would require co-operation from the academic community, the industry, and the professionals.

When that body of expertise is visible and accessible, the benefits can obviously be passed along to municipalities. In fact, consideration might be given to almost immediate creation of an embryonic clearing-house, based on existing expertise. Municipalities should be encouraged to do the same. There is no reason why they cannot follow the example of St John's at the level of expertise already available.

6.4.3 ASSISTANCE IN MARKETING HERITAGE PROPERTIES AND INTEGRATION WITH COIN

Part of the economic obstacle to the rehab of many heritage buildings is weakness in the market. An owner may feel that the

market demand for an existing building may not be sufficient to warrant its retention or rehab.

Market demand might often be substantially different if more people knew about the property. Throughout the Western world there are prospective buyers who seek heritage buildings, either for business or for personal use. The challenge is to bring supply together with demand. That challenge can be met by measures at the provincial or municipal level, or preferably at both together.

Various responses have been developed. One U.S. company, Sterling Investments, regularly advertises in publications, looking for certified historic buildings (i.e. buildings eligible for the special U.S. tax credits) in which to invest. Sterling prefers multi-million-dollar projects. Another U.S. firm, Morningstar, is more specialized: its advertisements state that it is looking specifically for large, redundant, certified historic buildings that can be converted into luxury hotels. In order to bring together supply and demand, a number of publications have started producing "classified ads" sections specifically for heritage properties. The American *Preservation News* is a good example.

In West Germany, the process was carried one step further. Most German state governments (Lander) produce catalogues of the major heritage properties that are in search of new buyers or investors. Unlike U.S. and British publications, the German catalogues focus on the most difficult cases (e.g. isolated abandoned castles, redundant churches). Accordingly, whereas a typical issue of *Preservation News* may show hundreds of properties, the Hessen state catalogue shows only eighty-five, a small minority of the heritage buildings on the market there at any given time. The German catalogues contain added important information, namely:

- tax incentives and grants for which each property is eligible, and

- what maintenance orders have been issued by the state.

In short, the prospective investor is given a fairly accurate idea of what he/she is getting into.

In a fairly small West German state like Baden-Württemberg, the first such catalogue was produced in 1980, with only twenty-nine properties listed. Six thousand copies were printed and were distributed primarily to real estate brokers and developers. Eighteen properties were sold right away, and since then practically all have been disposed of."

Could we combine the West German and American approaches, that is, produce a regular catalogue of the hundreds of interesting properties for sale (as in the United States), with an appendix outlining information similar to that of the German model? In fact, similar proposals have already been made by real estate

agents, who might find such a tool invaluable." The publication could be paid for by the real estate companies as they place their ads.

The West German catalogues are supplemented by information that is presented orally. The Germans have advisory services such as those in St John's, described earlier:

> During restoration, extensive expertise and technical advice [are] given. Recommendations as to the most suitable and competent craftsmen and architects are given and with properties of major significance a detailed investigation and documentation of the building [are] carried out before restoration is begun. In matters of financing, the curator gives professional advice with regard to the relatively complicated tax laws and is also of assistance in obtaining grants which are provided by the municipal, Federal and State authorities, according to the aesthetic, historical, scientific or technological interest of the building."

This type of advice goes beyond what is usually contemplated in Ontario, particularly in financial and fiscal advice. It would presuppose that the Heritage Branch or the Ontario Heritage Foundation obtained personnel expert in these subjects and mandated to provide such advice.

The end result, in the words of the chief conservator of one of the German state governments, is this: "The curator's job now includes a new aspect; *in a positive way* he has become a good estate agent dealing with the properties under his charge and with some say in the choice of whose hands his problem children fall.""

An even more elaborate precedent, in Canada, is the Computerized Ontario Investment Network (COIN), which became operational in January 1987. COIN maintains confidential computerized databases of entrepreneur profiles, submitted by entrepreneurs, and investor profiles, submitted by investors. COIN matches the two databases and submits to investors opportunities that meet their criteria. Investors can request a summary of an entrepreneur's business plan, and at the request of the investor COIN will arrange an introduction. Until this point, both parties remain anonymous. COIN's role terminates with the introduction."

COIN is going nation-wide with the same acronym, becoming the Canadian Opportunity Investment Network. The cost is shared by the Government of Ontario and a variety of major corporations.

The results, in the tourism sector, have been surprisingly good: there have been three times as many people willing to invest in tourism as there are applicants with tourism projects." There is no immediate reason to suppose that in heritage-oriented investments the prospects would be drastically different.

6.4.4 MANAGED WORKSPACES

"Managed workspaces" refers to a scheme applied extensively in the United Kingdom to reuse large redundant buildings such as warehouses, abandoned factories, schools, and hospitals.

The managed workspace is an application of the principle of "business incubators" to old buildings. The notion of business incubators is well known on both sides of the Atlantic. It focuses on making real estate available, on a highly competitive basis, for certain commercial and industrial purposes. The administration of a business incubator may be in public or private hands and may be on a for-profit or non-profit basis; in some cases, it is even handled directly by a municipal agency. The initiative could come from the province, from local authorities, or even from the private sector.

In the United Kingdom, the concept of managed workspaces (virtually synonymous with business incubators) has been applied methodically to many large old buildings. The idea is to subdivide a large space into small spaces for a multiplicity of small-scale businesses, often just starting up, which can share conference space, reception area, infrastructure, and so on. This simple idea was used in 1974 near Covent Garden in London. By the early 1980s, it was repeated over thirty times and its method was systematized."

During the late 1970s, the success of this format was based exclusively on management and marketing. Financing, however, continued to be a problem." That problem was resolved when Britain's banking legislation was liberalized. Introduction of the Industrial Buildings Allowance provided a tax incentive that developers were quick to exploit."

A further form of assistance for these projects has come from municipalities. Many local authorities in Britain:

- publish catalogues of properties that might be good sites (a variation on the West German system);
- commission planning studies that prepare an inventory of the market problems facing redundant buildings and develop strategies for solutions (an approach also used successfully by the Core Area Initiative project in Winnipeg);
- fund feasibility studies of individual projects; and/or
- become an economic partner in the project by leasing space or providing the building, in return for a share of the profits.

There are now so many of these projects under way in the United Kingdom that in 1984 they formed the National Managed Workspace Association.

6.4.5 BUILDING PRESERVATION TRUSTS AND LOW-INTEREST LOANS

The building preservation trust is used widely in the United Kingdom. The format is simple: it is usually a non-profit corporation with a registered charitable number. Its mandate focuses on the conservation and rehab of one or more heritage buildings or districts. Trusts can be small or large. Small ones may focus on a single building (and are not very different from several counterparts in Ontario such as museum societies that operate their own building). Large ones may focus on many projects; the British Historic Buildings Trust resembles the Heritage Canada Foundation.

British trusts differ from Canadian in two main ways. First, they have access to a special pool of money, called the Architectural Heritage Fund. That fund is also constituted as one of these trusts and receives its money almost equally from government and from private sources. It then lends that money to the other trusts at a preferential rate of interest (5 per cent, as opposed to 12-per-cent commercial rates). That arrangement reduces the carrying costs of a project and sets an example to private lenders who are providing mortgages. In the words of one writer, Alan Benrose: "You can use the Architectural Heritage Fund for blackmail just as well as anyone else, by saying here is somebody lending us money at 5 per cent, what do you mean you can't do the same?"" That argument, of course, has limitations.

Second, there are many of these trusts. Their format is not intrinsically better than that of foreign counterparts, but the British have become accustomed to them and use this formula readily and often.

There are several organizations in Ontario that have much in common with these trusts. However, Ontario has no institutionalized low-interest backer for these organizations comparable to the Architectural Heritage Fund. Further, there is not a large body of precedents to make life easy for organizers, and Revenue Canada's registration of charitable status for such entities is not automatic. The same applies to approvals by Ontario's Public Trustee, in the case of applications for charitable incorporation. The complicated exchanges of correspondence can take months and increase the set-up cost of heritage organizations, which can ill afford it. These latter problems might be mitigated in Ontario by simply drafting a standard form for establishment of such organizations (including applications for charitable status) and providing professional advice to organizers.

It would be possible also to consider establishing a counterpart to the Architectural Heritage Fund specifically for the non-profit sector.

6.4.6 CO-OPERATIVE APPROACHES TO INSURANCE

Insurance on older buildings is expensive, and when the building is in serious need of repair it may be virtually unobtainable. In the United States, there were complaints that insurance companies had "blackballed" or "redlined" entire districts, thereby impeding any institution interested in financing a rehab project there. Unless insurance were available, the lender would be left in a very insecure position. This treatment led to calls for legislative intervention; such discrimination would make mortgage financing impossible for renovation or anything else in those districts.

In Canada, there have been few comparable complaints of systematized discrimination; but some owners or renovators of older buildings complained about the difficulty of obtaining insurance at reasonable rates, or even any insurance at all - for example, in Old Montreal. Such difficulties could block any mortgage financing. Perhaps the largest official initiative to remedy this situation is Montreal's: "The City intends to join with the Insurance Bureau of Canada (IBC) and other interested parties to solve insurance problems involving co-operatives and non-profit groups, rooming houses, condemned buildings, and buildings in specific sectors such as Old Montreal."

Whether the complaints made in Old Montreal have counterparts among older buildings and districts in Ontario may be a useful subject for exploration.

6.4.7 INTEGRATION WITH GOVERNMENT HOUSING PROGRAMS

Housing programs exist at both the provincial and municipal level and represent one of the largest direct interventions by either level of government in the existing building stock. Housing renovation programs are a significant example.

Although government assistance for renovation affects only 5 per cent of repairs made," the total volume of rehab involved is enormous. In Montreal alone, it is expected that when existing programs reach full operational capacity (within the next few months) 3,500 housing units annually will receive subsidies for renovation."

The priority of many heritage proponents in Canada has therefore been to work closely with responsible officials, to assure that rehab programs would influence as many heritage buildings as possible and that the work had a positive impact on buildings affected, not only in terms of habitability but also in terms of aesthetics. A prominent example is the activity in St John's by the Newfoundland Historic Trust (NHT), in co-operation with CMHC and with the Newfoundland and Labrador Home Builders Association. The three organizations have worked very closely together. As a result, CMHC is satisfied that its disbursements have been well targeted and that, for example, subsidized exterior renovations will not be criticized as "inappropriate," particularly since NHT

has spent great effort on producing its own design concepts which would be cost-competitive with less sensitive designs. Local homebuilders in St John's have been satisfied, because the subsidized rehab has turned into a model that neighbours have felt inspired to emulate and so have commissioned contractors to do much further (unsubsidized) work. NHT has confided that its president (a real estate agent and former CMHC Neighbourhood Improvement Program co-ordinator) has, within ten years, witnessed the rehab of every "major" downtown residence and is now ready to mobilize for "the next rung down"!

This success raises the larger question of co-operation, by the advocates of heritage property, with all the major participants in the reshaping of Canadian communities. Until recently, there had been few direct overtures from the heritage constituency to either trade associations or housing authorities. Trade groups in Ontario include the Building Owners and Managers Association, the Canadian Institute of Public Real Estate Companies, the Canadian Real Estate Association, the Canadian Renovators' Council of CHBA (and the local renovators, councils), CHBA, the Ontario Home Builders' Association, the Ontario Real Estate Association (along with local real estate boards), and the Urban Development Institute. Most of these organizations have their own publications.

In addition, their viewpoint can be frequently read in *Building Renovation* or *Aluminews*. *Renew* magazine also bridges the gap between trade and heritage interests. Housing authorities include CMHC, the Ontario Housing Corporation and municipal counterparts, and the Ontario Ministry of Housing (e.g. the Housing Conservation Unit). Officials in the public sector are usually represented as well via the Canadian Housing and Renewal Association (and its publication, *Canadian Housing*), along with the Canadian Institute of Planners and the Ontario Institute of Planners.

There is room for much development of co-operative strategies. The integrated approach exemplified by St John's may therefore be among the most promising avenues for setting up a ripple effect through the entire community involved with the older building stock.

7 MUNICIPAL MEASURES

7.1 TAX MEASURES

Chapter 3 of this report outlined certain priorities in the area of property tax.

7.1.1 TAX INCREMENT FINANCING

A further measure, exclusively under municipal control, is tax increment financing. It may be considered for municipalities that have not introduced a moratorium on tax increases as discussed in section 3.2.1. The technique is simple: where taxes rise as a result of improvements to property, the municipality reinvests those extra funds in civic improvements to that same area.

Tax increment financing may permit public improvements that would not otherwise be constructed." Although the renovating property owner may be faced with a significant property tax increase, local improvements will presumably increase his/her property values.

7.2 REGULATORY MEASURES

7.2.1 TRANSFER OF DEVELOPMENT RIGHTS (TDR)

The transfer of development rights (TDR) system has been used in many North American cities to protect buildings that would otherwise be demolished for economic reasons. In many American cities, the approach is systematized; in cities such as Toronto, it tends to be used ad hoc.

TDR rests on a simple premise that is already well known to many officials across Ontario. Let us suppose that a two-storey building of architectural interest is on a lot that is zoned for six storeys. Let us further assume no viable economic use for the existing structure when compared to redevelopment. Under TDR, the owner can save the building and still make money by selling the four storeys of excess airspace (the "development right") to another site, which adds those four storeys to its allowable zoning. Needless to say, this is always accompanied by a series of carefully prepared conditions, to assure that the transferee project does not grow totally out of proportion and complies with other planning objectives.

This approach was systematized by John Costonis in his book *Space Adrift* some decades ago, for use in Chicago. The main drawback is that it presupposes a market for development rights. If a developer can already build as much as the market will bear, why should he/she go to the trouble of buying development rights from the owner of a heritage building?

In other words, an effective system of TDR presupposes a market for development rights which in turn presupposes zoning controls so restrictive that a developer would urgently want to add to his/her allowable development rights by purchasing some elsewhere. That is not a situation that exists in most Ontario municipalities.[100]

Nevertheless, TDR can be very useful in some situations; it therefore warrants a more systematized approach. Toronto has been working diligently in that direction, for obvious reasons. Can the approach be used on a more comprehensive basis?

7.2.2 ZONING INCENTIVES

Many municipalities have enacted by-laws that specify the extent to which designated heritage buildings can depart from standard practice.

For example, the by-law may explain in detail how designated heritage buildings are not subject to the same parking requirements as other buildings. In other cases, it may allow work on a non-conforming building. That is currently the case under Ottawa's heritage by-laws.

The issue is not identical to that of TDR, described above. TDR contemplates transfer of development rights from one lot to another. The present case, however, involves development of the existing lot in the face of disincentives in the zoning by-law.

This kind of issue is well exemplified in municipalities whose zoning states, for instance, that in certain zones there can be only one dwelling per lot. If the lot is large and there is a modestly sized building on its property, the owner may weigh the pros and cons of redevelopment against those of infill. Because of zoning (and possibly because of potential problems with "subdivision control"), infill may be immeasurably more complicated than straight redevelopment. Examples of difficulties in the way of infill might include problems with parking requirements, or setback, or garage entry, or a plethora of other conceivable topics addressed in a given zoning by-law. That is no incentive for conservation and use of the existing building.

The solution here would be to waive tactically certain zoning requirements. The terms and conditions of such waiver should be outlined, as much as is feasible, in official plans and generic by-laws, in order to prevent subsequent attacks alleging "spot zoning." This method should be used only sparingly (and when it does not defy proper planning principles), but it remains part of a municipality's potential arsenal. It would need to be exercised by a by-law, since each use of it constitutes a derogation from the existing zoning by-law.

Although a few Canadian works examine this subject,[101] it is not always an easy issue for municipal authorities to deal with. For example, some municipalities may be concerned that in derogating

from the zoning applicable to other properties they expose themselves to appeal to the Ontario Municipal Board (OMB). The possibility of making further clarifications available to urban authorities might be explored. Since the OMB takes into consideration policy directives issued by the Government of Ontario (and the Planning Act specifically foresees such directives), further policy directives might well clarify this and related issues on the interplay between heritage concerns and other land use matters.

7.2.3 PREFERENTIAL HOURS OF OPENING

One of Canada's most famous heritage districts, Vancouver's Gastown, was established because the provincial and municipal governments wanted to provide local owners and managers with an incentive. Its designation was tied to the notion that it would allow Sunday openings.[102]

Control of hours of opening is exercised not through zoning but through the province's Retail Business Holidays Act. Amendments to that act came into effect in the spring of 1989, after the so-called Sunday shopping debate. The implications for heritage properties and districts can be described as follows.

In practice, several heritage areas in Canada have received a major commercial incentive by being allowed to open stores when other areas are closed. Under the previous Ontario legislation, for example, so-called tourist zones were allowed to stay open at unusual times (e.g. Sunday). Historic districts such as the Byward Market in Ottawa had been named as such tourist zones and hence enjoyed this advantage.[103] Much of the downtown economy of neighbouring Hull, Quebec, rests on the premise that bars can stay open there two hours longer than in Ottawa. In short, the issue involves potentially millions of dollars in spending and the market position of many enterprises, without any direct government investment.

Ontario then moved in exactly the opposite direction. Under new legislation, there appears to be little prospect for using hours of opening tactically, unless other levels of government choose to do so - control over Sunday shopping is vested in regional governments and municipalities. Most urban areas in Ontario are still unfamiliar with the implications of using preferential hours of opening tactically, for the advancement of urban planning principles in general or heritage concerns in particular. This oversight might be addressed via explanatory materials or otherwise.

7.2.4 PREFERENTIAL APPROVALS

Owners of heritage buildings fear additional red tape surrounding proposals to renovate the structure. On a major project, the assortment of approvals can require months; delays of eighteen months to work out all the terms of a subsidized heritage renovation are not unknown.

In response to this situation, some U.S. municipalities have introduced the "Green Door Policy":[84] an automatic "urgent" sticker is attached to every application for the renovation of designated heritage properties. In Canada, Vancouver does so. In Yellowknife, the municipality went further: it committed itself to processing the technical aspects of heritage rehab projects within ten days.

In other words, this policy departs from the first-come, first-served principle which usually applies to the processing of all applications for permits. The actual effect of such a measure usually depends on the size of the community and of its municipal staff. In small towns and cities, a policy of preferential approvals may have merely cosmetic effect. If the processing time for plans was measured in days, then "queue-jumping" would have little tangible effect on the holding costs of the project, but the psychological impact may be important. Paradoxically, it is often in smaller communities (where red tape is at a minimum) that residents are most sensitive to red tape and to even the slightest delay in processing permit applications. Accordingly, such municipalities sometimes express strong concerns over the red tape associated with heritage approvals; a preferential system could have important political benefits there.

In larger cities, lead-time for plan approvals can reach into weeks and months. The holding costs on real estate development projects can rise accordingly. In those cases, a system of preferential approvals (which may cut lead-time by several weeks) can produce a significant financial saving.

7.2.5 APPROACHES TO CONDEMNED BUILDINGS

In some cities, a systematic rewriting of by-laws is under way to transfer buildings "condemned" (under building or fire codes) from the slate for demolition to the slate for renovation. In Montreal, for example, this reanalysis is expected to lead to amendment of the city's enabling legislation. The intention is to increase the city's ability to compel renovation.[85]

This topic has not enjoyed much study. Buildings condemned under codes in Ontario have often been considered write-offs, and owners and politicians have often equated condemnation with an invitation to demolish. However, there are innumerable instances of even minor infractions being used as a flimsy excuse to denigrate existing buildings. In Ottawa, for example, the City Hall itself has a ceremonial staircase that does not comply with the codes and which, technically, could lead to accusations from the building inspector and the fire marshal. By the same token there are examples of condemned buildings being successfully rehabbed and brought back into service. It may be advisable to review the documentation that Montreal has assembled on this subject, with a view (if necessary) to exploring the possibility of comparable initiatives in Ontario.

7.3 SUPPORTIVE MEASURES

7.3.1 POLICIES TARGETING JOINT ACTION BY OWNERS

Heritage strategy must contain a policy to encourage rehab of buildings on a scale of an entire block at a time. That, of course, is part of the rationale for Main Street programs; but the thinking is as applicable to residential rehab as to commercial rehab. It is a question of the realities of real estate.

It has been said that the three laws of evaluation are "location, location, and location." Let us suppose that an entrepreneur rehabs one building on an otherwise shabby block; the result may look beautiful, but location still represents a liability. The entrepreneur may still market the property (in the hope that others will follow his/her example and that the market will have confidence in the location), but the task is difficult. Many entrepreneurs will gladly be the second or third renovator on a block, but never the first.

How can one encourage developers to take joint action? If a developer can foresee what neighbours will do, the risk may be reduced dramatically. Furthermore, the marketability of individual buildings is much higher when they are in a renovated group.

In Ontario, Main Street programs and BIAs have been a step in the right direction. France has gone considerably further. France has introduced a special level of tax incentive designed specifically for reno projects that cover a large part of a block at a time. This incentive attracts entrepreneurs to form into groups and to engage in joint action.

France has used an even more radical measure for new construction on a very wide scale. The best example is the district of La Défense, near Paris. This was a huge piece of land that had been a freight yard and stockyard. In consultation with local community groups and real estate associations, government planners designed an entire city that would be built in the area, and the envelope of each building was described in considerable detail. The government then privatized the entire project, with individual building projects usually going to the highest bidder.

Accordingly, planners knew exactly what the eventual density would be, so that they could design infrastructure to exactly the right specifications. In the typical North American city, changes in density demand periodic redesign of infrastructure.

For developers at La Défense, risk was reduced, because they could get a very clear idea of what their neighbours would look like; delays and holding costs were reduced, because they knew exactly what kind of building they would be allowed to build; and substantial profits were likely on the land. Although developers

were buying into a stockyard, they knew that by the time their building was finished, the area would be the hottest real estate in Paris. This project would have been unthinkable if the developers had acted individually.

If this approach were transplanted into a historic district in Ontario, the initial step would be land assembly. This could be done in one of three ways. The first would be by purchase and expropriation (a controversial approach at best). The second method would be creation of a development company for which the owners would become co-proprietors in exchange for their real estate, in a kind of voluntary condominium arrangement or joint venture. (The agreement could provide for partitioning of the property once the project was finished, if so desired.) The third method would be to leave properties in the hands of the original owners but have them sign a binding contract to carry out the work on their own buildings. The exact format could depend on circumstances and personalities.

The next step would be rehab itself. Planning would involve significant government participation, which would in any event be essential to motivate owners to get involved in the first place. The key objective is to develop a comprehensive blueprint for rehab of the entire district, with finished buildings coming onto the market within a reasonable time of each other.

At first blush, the approach appears radically interventionist by Ontario standards. That is a misconception. The ultimate objective is for the government to create the right climate for the real estate industry, in order to minimize corporate risk, with the ultimate objective of a totally privatized venture. If it is interventionist, it is so in the direction of public/private-sector partnership, and not otherwise.

8 CONCLUSION

The stated objective of the Ontario Heritage Policy Review was "to ensure that the conditions, mechanisms and support exist to make [heritage] development possible - to enable individuals and institutions to find the human, financial and other resources necessary to achieve their objectives."[106]

This study has outlined recent and/or conceivable developments that could affect that mandate.

Some of those measures require little further action. For example, zoning incentives and code flexibility are already well launched in Ontario: the main task at this stage is to follow through.

Other issues are conceptually clear but require political will in order to be implemented. That is the case, for example, with a governmental commitment to locating in heritage properties. The Ministry of Culture and Communications has already made informal agreements with other ministries, but there is still a long way to go before tangible results are widespread.

Still other measures will require further study. For example, a province-wide development corporation tapping into private equity is a complex concept. Nonetheless, the economic consequences appear to make it worth the effort.

These developments are emerging against the backdrop of tax measures on three fronts: income, sales, and property. Any discussions with senior spokespersons in the private sector will need to take this context into account. Furthermore, the process of fiscal evolution is ongoing. Further refinements are not only anticipated but are essential for the economic health of the heritage movement. In fact, certain pre-emptive measures will be necessary: in other words, direct measures will have to be taken in certain areas so that conditions do not become worse before they get better.

With proper planning, Ontario can accomplish almost all the goals enunciated by the Ontario Heritage Policy Review. If a proper economic climate can be developed, through the tactical use of relevant and appropriate inducements and the reduction of regulatory and financial obstacles, then the prospects for the conservation and rehab of Ontario's heritage resources will improve substantially.

APPENDIX A

THE GOYER AND GOLD BAR CASES

A1 INTRODUCTION

In chapter 2, this study outlines some recent developments in the income tax treatment of the renovation of buildings. There have been major changes in the past two years in the way that income tax treatment is viewed. This appendix contains a summary of the events that gave rise to those changes.

A2 CONVENTIONAL WISDOM

The words "renovation" and "repair" are not defined in the Income Tax Act (Canada); however, the distinction between them is crucial. "Renovation" is assimilated to new construction. That means that, for investment properties, these expenses are "capital" in nature and hence are not deductible but merely depreciable. "Repairs" are usually considered current expenses and hence can be entirely tax-deductible in the year incurred. The distinction can therefore mean a drastic difference in the immediate net cost and cash flow of a project on a building.

In the absence of statutory definitions, the courts had developed criteria to distinguish between capital and current expenses on a building. The conventional wisdom was called the "once-and-for-all test" and dated back to a 1926 decision of Britain's House of Lords.[167] If the replacement of a building component were done "once and for all" (e.g. balconies, plumbing, doors, windows, and so on), then the expense was assumed to be capital and hence non-deductible. If the replacement were not "once and for all" but merely for a modest timespan (e.g. paint, lightbulbs, and so on), then the expense was assumed to be current and deductible. When a major project was undertaken on an old building, observers usually assumed that since most of the work would be "once and for all" most costs would be non-deductible and merely depreciable. To use the jargon of the trade, the cost would have to be "capitalized" instead of being "expensed." This focusing on the "enduring benefit" of work was articulated (along with a number of other tests) in Revenue Canada's Interpretation Bulletin IT-128R, referred to below in section A7.

Revenue Canada took that assumption one step further in the 1970s. The department announced that during the major renovation of "used" buildings it would consider all expenses capital - even those that would be normally current ... down to the last lightbulb. On November 11, 1981, Allan MacEachen's federal budget introduced a further wrinkle: the new section of the Income Tax Act (Canada), 18(3.1), would assimilate even soft costs to capital expenses.

Throughout this time, Quebec's own Income Tax Act was approximately keeping pace with the federal position. It had its own version of section 18(3.1), namely article 135.4.

A3 THE GOYER CASE

An unexpected challenge to the conventional wisdom arrived in the case of Mme Denise Goyer of Montreal. Her modest apartment building was in serious need of work; balconies, plumbing, windows, and doors were all deteriorating and needed replacement.

Negotiations on the tax treatment of these and other expenses were unsuccessful, and the matter went to Quebec Provincial Court. Hon. Judge Rodolphe Bilodeau ruled in favour of the taxpayer, and Revenue Quebec promptly appealed to the Quebec Court of Appeal. That court's unanimous decision was rendered, in 1987, by Mr. Justice Vallerand (Messrs Justices Nichols and Le Bel concurring); the Supreme Court of Canada, on October 21, 1987, declined leave to appeal that decision, which hence is the focus of attention.

The Quebec Court of Appeal began by mentioning the lack of statutory direction in the criteria for distinguishing between capital and current expenses: "The Appellant first reminds us of the following proposition by the Supreme Court of Canada: 'Parliament did not define the expression "outlay ... of capital". There being no statutory criterion, the application or non-application of these expressions to any particular expenditure must depend upon the facts of the particular case.' The National Assembly has done no better."

It next reviewed the jurisprudence, going back to 1926 and the House of Lords. Along the way, one encounters no less than two Supreme Court decisions and a wide assortment of judgments from other courts; however, two cases were considered the most persuasive of all: the Exchequer Court's decision in *Canada Steamship Lines v. M.N.R.*,[108] on naval refit, and the Federal Court of Appeal's judgment in *Shabro Investments v. R.*[109] As a lead-in to its own reasoning, the court quoted with approval the following from the latter decision: "The real problem ... is whether the replacement of the floor was merely the remedying of damage to the fabric of the building as it had theretofore existed, or whether it was an integral component of a work designed to improve the building by replacing a substantial part thereof by something essentially different in kind."

On that basis, Mr. Justice Vallerand addressed the question of whether the conclusive criterion was the "once-and-for-all test" or something quite different: "The scope of the repairs and of the expenses flowing therefrom is perhaps, in certain circumstances, an element of the solution. So is the longevity of the work. But the essential question is to know whether the expenses proposed for deduction are intended to create capital property or replace a disappeared good with another on one hand, or on the other hand to simply repair existing capital property."

The court said that this was indeed the true intent of the previous jurisprudence before the House of Lords and the Supreme Court. The conclusion was as follows:

> Maintenance and repair are what is done to *conserve* capital property. In principle, it matters little whether one replaces a few boards on a gallery, a few pieces of pipe each year - which would undeniably be current expenses - or, having left the property to deteriorate, one is compelled to make major longlasting repairs. As long as one is not *creating* new capital property, that one is not *increasing* the *normal* capital value of the property, and that one is not *replacing* a disappeared item with another, this is maintenance and repair which tends to *return* the capital specifically to its normal value.
>
> In this case, the balconies, plumbing, windows and doors, as decrepit as they were when they needed replacement, do not constitute ... *the capital property*, but merely its integral components, such that their replacement is not a replacement of the capital property itself but merely a repair.

A4 PARENTHETICAL QUESTION: IMPLICATIONS OF GOYER FOR PROPERTY TAX

Two questions have been raised with relation to the possible effect of the *Goyer* case on property tax:

1. If *Goyer* improves the prospects for rehab, does this not ipso facto improve the economic prospects of many old buildings and hence raise the threshold at which buildings can be declared functionally obsolescent for property tax purposes?

2. If the work conducted at a site is not a "capital" expense for income tax purposes, do property tax officials have the legal right to reassess?

Ontario's Ministry of Revenue is highly reluctant to import income tax notions into the property tax sphere[10] because it believes that the two tax systems differ so fundamentally that it is hazardous to apply the mechanics of one to the other.

Question 1 pertains to functional obsolescence. The argument has been made elsewhere that an improvement in the income tax treatment of rehab might ipso facto raise the threshold at which certain buildings can be declared functionally obsolescent.[11] The argument is that this improved tax treatment affects the "bottom line." In doing so, it lowers the level at which rehab becomes competitive with demolition or "mothballing." Conversely, that raises the threshold at which mothballing and demolition are viewed as the only economic option for the property; and that, ipso facto, raises the level at which buildings can be declared functionally obsolescent. Since functional obsolescence is a ground on which to claim significant reductions in the assessment

of a building for property tax purposes, the consequence of such reasoning is simple: by improving the economics for rehab, one can reduce the number of buildings that are assessment write-offs now ... without even waiting for any rehab. In other words, municipal property tax assessment can increase immediately, without waiting for any money to be invested.

A spokesman for the Ministry of Revenue doubted whether that argument was likely to produce results as dramatic as one would think. In fact, the view was that it might be difficult to perceive any direct or short-term results at all.

Despite that scepticism, this may not be the last word. The ultimate question remains the same: how does the building maintain its ability to earn income in a market sense? Could it be easily (and economically) changed in order to increase its ability to do so? The extent to which that changeover becomes easier would necessarily affect analysis of the building's ongoing ability to earn income.

The preliminary conclusion is therefore the following. Although it appears to be a tactical mistake to try to oversell the effects of *Goyer* and to argue that it has a direct effect on appraisal, there is at least an indirect ripple effect to be anticipated; although that latter effect may not be in the foreground of the appraiser's analysis of a given building, it should at least be in the background.

Question 2 pertains to the propriety of reassessment. If a given expense is juridically treated as a current expense instead of capital, is it even proper (or legal) for property tax appraisers to be reassessing the property? The response of the spokesman for the Ministry of Revenue was unequivocal: yes. Property tax systems stem from fair market value; the niceties of the income tax system have no direct bearing on the procedures followed by appraisers in pursuing their own independent mandate.

For example, whether a given work is "capital" or not does not enter into the equation. Let us suppose that Goyer's building were the example. Whether the work on her doors and balconies was capital or not is irrelevant. The appraiser merely notices that the earlier aesthetic and/or structural problems may affect the resale value and/or the earning capacity of the building. If so, he/she may reduce the appraisal accordingly. If the problem is corrected, and that results in an increase in either resale value or earning capacity, then there will be an adjustment upward. In other words, the income tax and property tax systems function quite independently.

AS THE GOLD BAR CASE

Between the dates in 1987 of the Quebec Court of Appeal's decision in *Goyer* and the final disposition by the Supreme Court, a case in Alberta bearing certain similarities to *Goyer* was decided by the Federal Court of Canada. The case reached similar

conclusions to *Goyer*. From all appearances, the court reached those conclusions independently.

The case was *Gold Bar Developments Ltd. v. R.*"[12] The taxpayer's 1966 apartment building in Edmonton had brickwork that was declared defective in 1979. That year, the bricks were replaced with metal siding.

The taxpayer deducted the work as current expense. The department reassessed, treating it as capital. The taxpayer filed notice of objection, but the department confirmed the reassessment. The department's position was upheld in 1985 by the Tax Court of Canada;"[13] the taxpayer then appealed to the Federal Court, Trial Division.

Mr. Justice Jerome delivered the decision at the Federal Court and allowed the appeal. He first quotes from the lower court in the following lengthy passage, the reasoning in which he would ultimately reject:

> "One asks, 'Would the building have had the same value in the marketplace when the problem of the falling bricks existed, as compared to a value after the problem was remedied?' I think not. A correction to the capital asset was needed; the expenditure was not of a recurring nature, but was made to bring about an advantage of an enduring nature to the capital asset. The expenditure was not a current expense made in the ordinary course of the company's business operation to earn income. Returning once again to the *Haddon Hall* case, Mr. Justice Abbott said at page 1002, 'Expenditures to replace capital assets which have become worn out or obsolete are something quite different from those ordinary annual expenditures for repairs which fall naturally into the category of income disbursements.' While in this case, there is no replacement of a worn out or obsolete capital asset there is a major expenditure made to put the capital asset in a proper condition, and certainly the expenditure is not an ordinary annual one. Applying then both a common sense approach to classify the expenditure and the test in the *Haddon Hall* case, I find that the expenditure in this case is of a capital nature and, accordingly, this appeal is dismissed."[14]

In response, Mr. Justice Jerome not only disagrees but treats the "once-and-for-all test" as inconclusive:

> With respect, I take a different view. I do not think the solution to this problem can be found in the effect of the expenditure. It is expected that repairs to a capital asset should improve it. Where the source of income is a residential apartment building, that is always the case, especially where the repairs are substantial. Nor do I find the "once-in-a-lifetime" approach of much assistance. The more substantial the repair, the less likely it is to recur

(certainly the fervent hope of the building owner) but it remains a repair expenditure nonetheless."[115]

Instead, the court adopted a "subjective test":

> I think it is more helpful to emphasize the purpose of the outlay by the taxpayer. What was in the mind of the taxpayer in formulating the decision to spend this money at this time? Was it to improve the capital asset, to make it different, to make it better? That kind of decision involves a very important elective component - a choice or option which is not present in the genuine repair crisis ... The decision to spend the money was a decision to repair to meet that crisis and despite the fact that I am sure the plaintiff's expectation was, and still is, that it will not recur in the lifetime of the building, it remains fundamentally a repair expenditure."[116]

Finally, the court addressed the issue of substitution of materials: "I cannot accept the suggestion, however, that once the decision to repair is forced upon the taxpayer, he must ignore advancements in building techniques and technology in carrying out the work ... Nothing in this repair project attempted to change the structure of the building. What was done was neither more nor less than was required to replace the deteriorating and dangerous brick condition."[117]

A6 FOLLOW-UP BY REVENUE QUEBEC

The *Gold Bar* case was decided without any reference to *Goyer*, and vice versa: when the Supreme Court of Canada in October 1987 dismissed the application for leave to appeal in *Goyer* (six months after the Federal Court's *Gold Bar* decision), it made no reference to the latter.

Two months after the Supreme Court's ruling, Revenue Quebec issued its own interpretation bulletin, IMP 128-4.[118] It actually referred to the *Goyer* case by name and concluded that an expense incurred for the purpose of acquiring, adding to, or improving property is considered an ineligible expense in computing the income from leasing of property and is capitalized.[119]

In the process of establishing the nature of an expense, it is no longer relevant to know if the expense:

- is short term or long term;
- is likely to recur or not over the useful life of the property;
- is made once and for all or not;
- prevents or does not prevent deterioration of the property;
- brings or does not bring a lasting advantage to the property; or
- represents or does not represent a major disbursement in relation to the value of the property.[120]

It is essential to know if the expense resulted in:

- increasing the normal value of the asset;
- replacing an asset that had ceased to exist;
- creating a new asset; or
- restoring the asset to its normal value, that is, the value it would have if it were in very good condition.

For example, an expense incurred to replace all of the building's windows, or to repair the whole roof or the plumbing, is considered an eligible expense to be deducted if it resulted only in bringing the building to its normal value.[12]

A7 EFFECTS OF GOYER AND GOLD BAR ON REVENUE CANADA'S PREVIOUS POSITION

The position of Revenue Canada on the distinction between "capital" and "repair" was expressed in Interpretation Bulletin IT-128R. (It is annexed hereto as Appendix B.) IT-128R was introduced in May 1985 and builds on positions taken by the department since 1973. It antedates both *Goyer* and *Gold Bar*. As with other interpretation bulletins, it is not "law" in and of its own right; it is the department's own interpretation of the law.

IT-128R addresses a variety of subjects, including:

- kinds of property that give rise to capital cost allowance (CCA);
- CCA on partnership assets;
- works on property not owned or leased by the taxpayer;
- capital expenses versus repairs.

It is this last item that affects the *Goyer* situation. One will recall that in *Goyer*, the courts outlined a three-pronged test for tax deductibility of renovation work. The project cannot

- expand the building;
- replace items that had disappeared for a lapse of time; and
- be inconsistent with the "normal capital value" of the building.

If the project passed that test, the courts said, it would be deductible, and they said nothing about any further qualifiers.

In contrast, IT-128R (see the full text in Appendix B) advances a six-pronged test for distinguishing between non-deductible capital expenses and deductible repairs. A work that fails any of these six tests may be treated as non-deductible. Those six criteria can be summarized as follows:

Par. 4(a) "enduring benefit"	This is akin to the "once-and-for-all" test used in previous conventional wisdom, to the effect that work conferring an "enduring

	benefit" (as opposed to short-term work) is presumed to be capital. This entire paragraph would need to be reconsidered by the department, since both *Goyer* and *Gold Bar* treated this test as inconclusive.
Par. 4(b) "Betterment"	Work that raises property beyond any condition it had enjoyed before is presumed to be capital. This is consistent with both *Goyer* and *Gold Bar*, but *Gold Bar* appears to introduce more flexibility into what kinds of "technological improvements" can be made and still meet this test.
Par. 4(c) "Integral Part or Separate Assets"	Acquisition of parts that are not integral to the structure is presumed to be capital.
Par. 4(d) "Relative Value"	If the "repair" is of high value in proportion to previous repairs and/or the rest of the structure, the department presumes a capital expense. That test was undermined implicitly in *Goyer* and explicitly in *Gold Bar*. The department was cautious, in IT-128R, in not overstating the decisiveness of this test; however, reconsideration would be timely in light of jurisprudence.
Par. 4(e) "Acquisition of Used Property"	The department treats repairs on newly acquired property as capital, even though they would otherwise be treated as tax-deductible repair. However, this wording in paragraph 4(e) is still difficult to reconcile with the actual wording in *Goyer* and would need to be articulated more carefully.
Par. 4(f) "Anticipation of sale"	The department treats repairs to fix a building in anticipation of sale as capital. As in the case of paragraph 4(e), it is difficult to see how the department could reconcile this wording with the unequivocal language of *Goyer*, which contains no ifs, ands, or buts.

How does one reconcile the above criteria with the language of the courts? In the case of paragraphs 4(a) and 4(d), no reconciliation is possible, and redrafting of the interpretation bulletin appears unavoidable. Paragraphs 4(b) and 4(c) are non-issues at this time. In the case of 4(e) and 4(f), the situation is more delicate.

At first blush, the language of the courts is utterly unequivocal. In *Goyer*, for example, the courts outline a three-pronged test ... and no other; if the work meets that

test, it is tax-deductible. The courts made no allusion to any other tests or conditions. This language would therefore lead taxpayers to believe that the three-pronged test is conclusive and that there are no other hidden tests that could undermine the deductibility of a given repair.

The department may presumably reply that the reason why the courts outlined no other tests, such as the ones at 4(e) and 4(f), was that the courts did not need to. The department may presumably attempt to insulate paragraphs 4(e) and 4(f) from *Goyer* and *Gold Bar* by saying that, in the fact situation of those cases, owners were neither buying nor selling, and so 4(e) and 4(f) were irrelevant. By that reasoning, the other disqualifications to deductibility on repair may still exist, even if the courts did not refer to them.

Although a coherent reconciliation of 4(e) and 4(f) with *Goyer* will be difficult, that issue will not be resolved in the absence of a redrafted interpretation bulletin. As of the date of this writing, that response is being awaited.

A8 PROBLEMATIC TERMINOLOGY IN GOYER

Although the word "crisis" was used in *Gold Bar*, its absence from Revenue Quebec's IMP 128-4 (December 1987) and, more important, from *Goyer* suggests that this was not the factor on which the decision of the higher courts turned. Instead, the *Goyer* case focused on the three-pronged test based upon:

- additions and improvements;
- replacement of disappeared components; and
- increase in "normal capital value."

How can one feel confident that a given project passes the *Goyer* test and qualifies as "maintenance and repair"? The first two components of the test are straightforward enough: the project cannot physically add to the property and cannot replace items that had disappeared for a lapse of time. But the third criterion is immensely more difficult: how can one state that a project does not change the "normal" value of the building? What does that even mean?

The court provided very little guidance to answer that question. It did indicate that it is disposed to treat as current expense a project that merely does, in one swoop, what could have been done gradually (e.g. replacing an entire balcony rather than replacing it board by board). Perhaps more significant, the court bluntly concluded that new plumbing, new doors, new windows, and new balconies were current expenses when they merely replaced worn-out building components. Those could not have been replaced in dribs and drabs.

One gets the impression that the court was leaning toward the notion that buildings have a "state of entropy," so to speak - that is, the state that presumably prevailed immediately after

they were built, and for which they were designed. It is arguable that this is a building's "normal" condition, which would continue so long as the building were properly maintained and worn-out parts were periodically replaced. If the court did indeed mean "state of entropy" when it referred to the "normal" state of a building, this could conceivably represent a workable new test in the future, to assist in categorizing capital and current expenses.

The reference to normal "value" has, however, caused some further confusion. The use of that word prompted Revenue Quebec to add the following phrase to its interpretation bulletin IMP 128-4: "if a tax payer acquires a building at a price below its normal value and that, due to the condition of the asset when he bought it, he must incur an expense to bring the building back to its normal value, the expense must be capitalized."[122]

This has led some observers to infer that if an entrepreneur were to buy a property and proceed immediately to rehab (i.e. a developer), there would be an automatic presumption that he/she had bought the property with the full expectation that he/she was buying at "below normal value" and with the equal expectation that the rehab was part and parcel of his/her real acquisition cost. In other words, a rehab project undertaken immediately after purchase would be presumed to be outside the effect of *Goyer* and would be presumed to be capital. That approach leads to a number of observations.

If developers are to be excluded from *Goyer*, tax officials will have to come up with a clearer articulation than did Revenue Quebec. The wording used in IMP 128-4 runs squarely contrary to the actual wording of the judgment: in *Goyer*, the court was prepared to allow (as a current expense) expenditures as follows:

"As long as one is

- not *creating* new capital;
- that one is not *increasing* the *normal* value of the property; and
- that one is not *replacing* a disappeared item with another,

this is maintenance and repair which tends to *return* the capital specifically to its normal value."[123]

Obviously, the court went to some pains to emphasize that a non-capital expense included one that "tends to *return* the capital specifically to its normal value." Therefore, at first blush, Quebec's reference to capitalizing "an expense to bring the building back to its normal value" appears impossible to reconcile with the above wording of the judgment.

A9 GEOGRAPHIC APPLICATION OF GOYER

After the Supreme Court in 1987 declined the leave to appeal in the *Goyer* case, a number of questions emerged concerning the

impact of the Quebec Court of Appeal's decision. Most important, would it apply beyond Quebec? The court itself appeared to answer that question, when it argued that neither the federal nor provincial government had provided statutory definitions. In fact, the court went to some pains to treat both systems, on this specific issue, as being subject to the same principles.

One would have thought, therefore, that this was a non-issue; and one would also think that the *Gold Bar* case would reinforce the notion that these principles would have nation-wide application. However, at a meeting in Ottawa, a representative of Revenue Canada gave business people the impression that (in his opinion) *Goyer* applied only to Revenue Quebec.

Three measures were undertaken by observers to ascertain whether this were actually the federal government's position. First, this writer had a client who was prepared to undertake *Goyer*-type work on a property in Ontario and to solicit an advance ruling from Revenue Canada. That was done in December of 1988. A preliminary response was delivered by a senior Revenue Canada official in January 1989. In the latter's view, the taxpayer was ineligible for *Goyer*-type treatment on grounds totally extraneous to geographical location (see section 2.6 of this study). In fact, geographic location was treated as a non-issue.

Second, in December 1988, the Canadian Home Builders' Association wrote to the minister of finance, the Hon. Michael Wilson, to obtain assurance that the *Goyer* case would not be rolled back in the next budget. The minister's reply was received by the CHBA on March 6, 1989. It went through the *Goyer* case in some detail and concluded that there would be no immediate plan (at Finance Canada) to roll back the decision. The letter made it clear that Finance Canada was conversant with the case; there was not the slightest hint of any attempt to distance the federal government from the case's effects on geographical or other grounds. There is a necessary inference that if the minister could have challenged the geographic application of the case, he would have done so.

Third, for the sake of still further prudence, the CHBA has written to the minister of national revenue, the Hon. Otto Jelinek, with a request for Revenue Canada to issue a new interpretation bulletin which specifies the application of the *Goyer* case nation-wide, along with the technical implications. It now appears that the department is moving in that direction.

A10 TIMING OF GOYER

The next question is whether the decision in *Goyer* is undercut by section 18(3.1) of the federal Income Tax Act or article 135.4 of the Quebec Income Tax Act, both of which were introduced on November 11, 1981. Those sections swept all kinds of expenditures (including soft costs) holus-bolus into capital expenses. The court cases do not specify when Mme Goyer's expenses were undertaken. In point of fact, they were entered

in the 1980 tax year, so they antedated sections 18(3.1) and 135.4. Is it possible that they were current only because they antedated the sweeping effect of 18(3.1) and 135.4? In other words, do the latter provisions wipe out the possibility of deductibility for similar expenses incurred after 1981?

That reasoning is untenable. According to the wording of sections 18(3.1) and 135.4, these clauses take effect only in case of "construction, renovation or alteration"; but that does not include mere "repair." In other words, if the jurisprudence says that a given project is "maintenance and repair" (as opposed to construction, renovation, and alteration), then section 18(3.1) and its counterparts do not apply. The government of Quebec felt compelled to come to that conclusion. It produced an interpretation bulletin confirming the *Goyer* conclusions notwithstanding the fact that it has its own version of section 18(3.1); it would hardly have done so if that clause had been of any assistance. A further corollary to that conclusion is that soft costs would not necessarily need to be capitalized, under section 18(3.1), if the nature of the project is "repair" instead of "renovation."

Finally, if the timing issue had been relevant, one would have expected it to be raised either by the senior Revenue Canada official who was dealing with the request for advance ruling by this writer's client or by Mr. Wilson or by Mr. Jelinek in their letters to the CHBA.

A11 INTERIM CONCLUSION

Various consequences of *Goyer* are described in the body of this study, in chapter 2. Further exploration of the issue will presumably be required upon delivery of Revenue Canada's position, in response to the CHBA's request for a redrafted interpretation bulletin.

APPENDIX B

INTERPRETATION BULLETIN IT-128R

(REVENUE CANADA, MAY 1985)

APPENDIX C

SMRQ v. GOYER

(QUEBEC COURT OF APPEAL, 1987)

APPENDIX D

GOLD BAR DEVELOPMENTS v. R.

(FEDERAL COURT OF CANADA, 1987)

APPENDIX E

INTERPRETATION BULLETIN IMP 128-4/R1

(REVENUE QUEBEC, 1987)

NOTES

1 Ontario Heritage Policy Review, OHPR, Ministry of Citizenship and Culture, *Heritage: Giving Our Past a Future*, Toronto, April 1987, 3, 19.

2 OHPR, *Summary of Public Submissions*, Toronto, April 1988.

3 Heritage Canada Foundation, *A Brown Paper on Heritage Legislation*, Ottawa, 1974.

4 "Preservation Law, Building Codes and Assorted Prognostications," *APT Bulletin*, 1980, no. 1, 25.

5 See the cover story in Time, Nov. 23, 1987. See also Marc Denhez, *For Economic Renewal*, Vols. I and III, Ottawa, Building Revival Coalition, Dec. 1986.

6 See Canadian Home Builders' Association (CHBA), *Housing in Canada*, March 1989. See also "Construction Industry Gears for Change," *Financial Post*, Feb. 27, 1989.

7 Ibid.

8 CHBA, *The Renovation Sector of the Canadian Homebuilding Industry*, Ottawa, 1988, 7.

9 Quoted in *Building Renovation*, Jan./Feb. 1989, 5.

10 Quoted in ibid., 3.

11 CHBA, *The Renovation Sector*, 4.

12 Ibid., 5.

13 Ibid., 3. See also CHBA, *Directions for the 1990s*, Ottawa, 1989, 17.

14 *For Economic Renewal*, Vol. I, 26.

15 According to John Fennell, editor of *Building Renovation* magazine.

16 CMHC, *The Canadian Renovation Market*, Ottawa, 1986.

17 The total value of Canada's pre-1941 building stock was tentatively placed at $114.9 billion by Statistics Canada: see *For Economic Renewal*, Vol. III.

18 See ibid.

19 This is the inevitable result of the wording of the legislation. Section 26(5) of the Ontario Heritage Act allows for "objections to proposed designations." It says nothing about objections to a refusal to designate. No such appeal procedure exists. Although the act later refers, at section 31(5), to a third conceivable instance, namely objection to a by-law repealing a designation, such objections and

instances are overwhelmingly more rare than the first two categories. This orientation of the act says much about the assumptions on which the legislation was based.

20 See I.C. Bouuaert, *Tax Problems of Historic Houses in the States of the European Economic Community*, Brussels, Commission of the European Communities, 1979.

21 "I feel that our current system of tax incentives work in a very direct and definite way against enlisting private funds in historic restoration projects"; Senator J. Glenn Beall (R), 121 *Congressional Record*, 3004 (1975). For a summary comparison of the chronology of events in the United States, Europe, and Canada on tax treatment of the rehab of heritage properties, see *For Economic Renewal*, Vol. I.

22 James Watt, quoted in OHPR, *Heritage: Giving Our Past a Future*, 15.

23 Convention Concerning the Protection of the World Cultural and Natural Heritage. Acceded to by Canada, July 20, 1976.

24 Ibid., article 5(a).

25 Ibid., article 5(d).

26 *For Economic Renewal*, Vol. I.

27 1987 R.J.Q. 998 (Que. C.A.); Leave to Appeal to the S.C.C. denied, Oct. 21, 1987.

28 87 D.T.C. 5152. See Appendix A for elaboration.

29 Ibid.

30 *Highland Railway Co. v. Balderston*, (1888) Tax Cas. 485 (Scot.); also *Tank Truck Tpt. v. M.N.R.* (1965), 38 Tax ABC 332 (TAB).

31 Part of the *ratio* (rationale) of the *Highland Railway* case was that upgrading could be presumed precisely because the item being replaced had not "worn out or partially worn out" (p. 448).

32 See Appendix A, section 6.

33 Marc Denhez, "What Price Heritage?" *Plan Canada*, March 1981.

34 Alberta Historical Resources Act, section 24.

35 Unfortunately, the source of this legal opinion, a member of the legal staff of a large Alberta municipality, asked not to be quoted.

36 See "What Price Heritage?"

37 (1984) C.P. 250.

38 "What Price Heritage?" See David Listokin, *Landmarks Preservation and the Property Tax*, New Brunswick, N.J., Rutgers University, Center for Urban Policy Research.

39 See Edmonton's technique to favour rehab at the Hotel Macdonald: By-law 7298.

40 See the tax-freeze techniques used in Perth, Ontario: By-law 2294.

41 "What Price Heritage?" Favourable comments on this technique are found in a number of texts, such as C.J. Duerken, ed., *A Handbook on Historic Preservation Law*, Washington, D.C., National Trust for Historic Preservation, 1983, 448-59, and Gregory Andrews, ed., *Tax Incentives for Historic Preservation*, Washington, D.C., 1980.

42 In the case of new construction, some Canadian municipalities had created such a web of property tax incentives (called "bonusing") that provincial legislatures intervened to limit this activity. See Ian MacF. Rogers, *The Law of Canadian Municipal Corporations*, 2nd ed., Toronto, Carswell, Vol. II, 863.

43 *Assessment Authority of B.C. v. City of Victoria.*

44 The source of this legal opinion asked not to be quoted.

45 Article 5(d).

46 This is the case in the United States. See above, note 22.

47 One particularly articulate appeal for such an approach appeared in the report of C. Les Usher to the Alberta government: "There are concerns about getting a larger number of stakeholders, from municipalities through the corporate sector to the public at large, who are not involved, to participate in the preservation movement. These Albertans need to be motivated to do something; it is recognized at the same time, however, that the motivation process should transcend moral commitments and legal obligations so that Albertans should want to preserve resources instead of being compelled to do so"; *Financing of Historic Resources in Alberta*, Edmonton, Alberta Culture, 1981.

48 Donald Lidstone, "Impact of the Charter of Rights and Freedoms," Planning Institute of British Columbia, Kamloops, May 10, 1985, p. 15. Lidstone did an inventory of possible legal avenues to challenge the constitutionality of heritage legislation. Memoranda at the B.C. Ministry of the Attorney General play down the risk that such arguments represent. However, since "reasonableness" is a defence to Charter challenges, a government that has developed an extensive quid pro quo for designation has taken at least some valuable steps to insulate itself from such challenges, if they were to occur.

49 Listokin, *Landmarks Preservation and the Property Tax.*

50 Published by Economic Analysis, Policy and Planning Division, Department of Development, Government of Nova Scotia, Halifax, December 1989.

51. Ibid., p. i.

52. See Bouuaert, *Tax Problems of Historic Houses.*

53. *Federal-Provincial Working Group Report to Tourism Ministers on Financing Instruments and Concepts for Canadian Tourism Product Development*, Ottawa, Tourism Canada, March 1988.

54. Ibid., 19.

55. It is described in considerable detail in ibid.

56. Ibid.

57. Ibid., 40.

58. Ibid., 42.

59. Ibid.

60. Ibid.

61. Ibid., 35.

62. Ibid.

63. Ibid.

64. Ibid., 48.

65. John Fennell, "Comment: Look for More Regulations" (editorial), *Building Renovation*, May/June 1989, 3.

66. Ibid.

67. Ibid., views ascribed to John Fennell.

68. Ibid.

69. Ibid.

70. *Federal-Provincial Working Group Report*, 54.

71. Ibid., 53.

72. Ibid., 55.

73 The National Building Code is not a law but a model document drafted by the National Research Council of Canada.

74 In the past, it was not uncommon for an applicant who proposed partial renovation (e.g. plumbing) to be confronted with a building inspector who responded that only a total renovation (plumbing plus electrical plus structural, and so on) would meet code requirements. In other words, it was "all or nothing." This was a strong incentive to demolish and has been significantly mitigated by Part XI.

75 40 U.S.C. sections 606 et seq.

76 Section 611.

77 Section 606.

78 "Preservation responsibilities of state agencies have increased in some states as a result of recent comprehensive state laws. Arizona, along with California, New York, and Oregon, has put a premium on the reuse of state-owned historic buildings: all state agencies must give first priority to reusing historic buildings under state control rather than leasing, buying, or constructing other ones. The State Historic Preservation Office [SHPO] in each of these states is to maintain a listing of all historic buildings available for state agency use. Each state agency must assist in compiling the list, and buildings generally do not have to be on the state register to qualify. For example, California requires the inventory to include all buildings over 50 years old, regardless of whether they are on the register. Property that a state agency intends to sell or transfer should be protected by a preservation restriction such as an easement. Similarly, Pennsylvania requires all state agencies to submit proposals to alter state property to the [authorities] for review and, where appropriate, to execute 'covenants, deed restrictions, or other contractual arrangements' to preserve the historic resource. By executive order, Maryland directs all state agencies to guide physical and economic development into existing developed areas in a manner that not only protects historic resources but encourages their reuse. The newly formed state development council, composed of various state agencies and the SHPO, targets areas for development compatible with historic preservation. Pennsylvania's law requires each state agency to initiate procedures for considering historic resources in administering its own programs. In Arizona, the SHPO must submit an annual report to the governor that comments on the preservation performance of each state agency." Duerken, ed., *Handbook*, 165.

79. Ibid.

80. See Marc Denhez, "The High Rise Follies," *Canadian Heritage*, Summer 1989.

81. These observations were made in personal conversations with the lawyers of the National Trust for Historic Preservation and the Preservation Law Center, both in Washington, D.C.

82. World Heritage Convention, article 5(a).

83. In a speech to the Canadian Association of Planning Students (Hotel Fort Garry, Winnipeg, Jan. 26, 1985) Michael Decter, then clerk of the cabinet of Manitoba, outlined a commitment to that effect.

84. *Federal-Provincial Working Group Report*, 24.

85. Contrary to popular misconception, the building stock in St John's is not significantly older than that of the typical Ontario municipality. The downtown was destroyed by fire in the 1890s and rebuilt at that time. However, the fire was in winter, and the rebuilding took place in great haste; as a result, some hazardous materials, including spruce, were used. The challenges involved in rehab of that building stock tend to be greater than those in Ontario.

86. Cristoph Mohr, "Derelict Monuments and the Problem within Conservation of Finding New Uses for Them," *The Financing of the Architectural Heritage*, Strasbourg, Council of Europe, 1987.

87. For example, one such proposal was developed, quite independently, by Heritage Ottawa and is currently being negotiated with the local real estate community.

88. Mohr, "Derelict Monuments," 50.

89. Ibid.

90. *Federal-Provincial Working Group Report*, 57.

91. Ibid., 58.

92. Peter Eley and John Worthington, *Industrial Rehabilitation: The Use of Redundant Buildings for Small Enterprise*, London, Architectural Press, 1984. Standardization of the managed-workspace approach has its problems. It is estimated that among these thirty enterprises, only a few are living up to expectations. Various reasons have been advanced. Many volunteer boards lack the time and motivation to do first-rate real estate deals, and the amount of capital available is often insufficient to carry out a major project.

93. See URBED, *Recycling Industrial Buildings*, Edinburgh, Capital Planning Information, 1981.

94. Nicholas Falk, "Trends in the Reuse of Industrial Buildings," *Financing of the Architectural Heritage*.

95. Alan Benrose, "Building Preservation Trust and Revolving Funds in the United Kingdom," *Financing of the Architectural Heritage*.

96. "Habiter Montréal," *Canadian Housing*, Summer 1989, 29.

97. Paul Angers, quoted in "Residential Rehabilitation: Where Is It Heading?" *Canadian Housing*, Dec. 1988/Jan. 1989, 41.

98. "Habiter Montréal," 28.

99. Planning Services Division, Alberta Municipal Affairs, *Development Incentives: The Advantages and Disadvantages in Municipal, Financial and Land Use Incentives*, Feb. 1988, Executive Summary.

100. A comparable situation in Alberta has been described in substantial detail in ibid.

101. For example, ibid.

102. See Marc Denhez, *Heritage Fights Back*, Ottawa, Heritage Canada and Fitzhenry & Whiteside, 1978, 211.

103. Marc Denhez, "Cityscape," *Ottawa Citizen*, Oct. 29, 1988, H3.

104. The origins of this expression are obscure, at least to this writer.

105. See, for example, "Habiter Montréal," 28-9.

106. OHPR, *Heritage: Giving Our Past a Future*, 26.

107 *British Insulated and Helsby Cables vs. Atherton*, (1926) A.C. 205 at 213-14.

108 (1966) 20 D.T.C. 5206-7.

109 (1979) 33 D.T.C. 5107.

110 Based on interviews with the Policy and Legislation Section of the Assessment Policies and Priorities Branch of Ontario's Ministry of Revenue.

111 Speech to Waterloo Regional Heritage Foundation, Conestoga College, Kitchener, April 1, 1989.

112. 87 D.T.C. 5152.

113 85 D.T.C. 513.

114 87 D.T.C. 5153.

115 Ibid.

116 Ibid., 5153-4.

117 Ibid., 5354.

118 Dated Dec. 21, 1987.

119 Article 7.

120 Article 10.

121 Article 12. The article continues with further wording that is referred to below, in section A8.

122 Article 12 (continued).

123 1987 R.J.Q. 992.

APPENDIX B

REVENUE CANADA INTERPRETATION

BULLETIN IT-128R

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INTERPRETATION BULLETIN

SUBJECT **INCOME TAX ACT**
Capital Cost Allowance – Depreciable Property

NO **IT-128R** DATE **May 21, 1985**
REFERENCE **Paragraphs 20(1)(a) and 13(21)(b) (also Regulations 1102(1))**

This Bulletin replaces and cancels Interpretation Bulletin IT-128 issued on October 29, 1973. Revisions of substance are designated by vertical lines.

1. The classes of property described in Part XI of the Regulations and in Schedule II in respect of which capital cost allowances are deductible under paragraph 20(1)(a) in computing income do not include property that was not in fact acquired by the taxpayer or property listed in Regulation 1102(1), a partial list of which includes

(a) property the cost of which is deductible in computing the taxpayer's income.

(b) property that is described in the taxpayer's inventory.

(c) property that was not acquired for the purpose of gaining or producing income.

(d) property that was acquired by an expenditure in respect of which the taxpayer is allowed a deduction under section 37.

(e) property that was acquired after November 12, 1981 that is

(i) a print, etching, drawing, painting, sculpture, or other similar work of art, the cost of which to the taxpayer was not less than $200,

(ii) a hand-woven tapestry or carpet or a handmade appliqué, the cost of which to the taxpayer was not less than $215 per square metre,

(iii) an engraving, etching, lithograph, woodcut, map or chart, made before 1900, or

(iv) antique furniture, or any other antique object, produced more than 100 years before the date it was acquired, the cost of which to the taxpayer was not less than $1,000,

other than property that was acquired from a person with whom the taxpayer was not dealing at arm's length (otherwise than by virtue of a right referred to in paragraph 251(5)(b)) at the time the property was acquired if the property was acquired in circumstances where the

BULLETIN D'INTERPRÉTATION

SUJET **LOI DE L'IMPÔT SUR LE REVENU**
Déduction pour amortissement – Biens amortissables

N° **IT-128R** DATE **le 21 mai 1985**
OBJET **Alinéas 20(1)a) et 13(21)b) (également le paragraphe 1102(1) du Règlement)**

Le présent bulletin annule et remplace le Bulletin d'interprétation IT-128 du 29 octobre 1973. Les révisions d'importance sont indiquées par un trait vertical.

1. Les catégories de biens mentionnées dans la Partie XI du Règlement et dans l'Annexe II, à l'égard desquelles des déductions pour amortissement sont déductibles en vertu de l'alinéa 20(1)a) lors du calcul du revenu ne comprennent pas les biens qui n'ont pas été effectivement acquis par le contribuable ou les biens énumérés au paragraphe 1102(1) du Règlement, dont une liste partielle comprend

a) les biens dont le coût est déductible dans le calcul du revenu du contribuable.

b) les biens qui figurent dans l'inventaire du contribuable.

c) les biens qui n'ont pas été acquis dans le but de gagner ou de produire un revenu.

d) les biens qui ont été acquis dans le cadre d'une dépense qui confère une déduction au contribuable en vertu de l'article 37 de la Loi.

e) les biens qui ont été acquis après le 12 novembre 1981 et qui sont

(i) une estampe, une gravure, un dessin, un tableau, une sculpture ou une autre oeuvre d'art de nature semblable dont le coût, pour le contribuable, n'est pas inférieur à 200 $,

(ii) une tapisserie ou un tapis tissé à la main ou une application faite à la main dont le coût, pour le contribuable, n'est pas inférieur à 215 $ le mètre carré,

(iii) une gravure, une lithographie, une gravure sur bois ou une carte qui date d'avant 1900, ou

(iv) un meuble ancien ou tout autre objet ancien fabriqué plus de 100 ans avant la date de son acquisition dont le coût, pour le contribuable, n'est pas inférieur à 1 000 $,

autres que les biens acquis d'une personne avec laquelle le contribuable avait un lien de dépendance (autrement qu'en vertu d'un droit visé à l'alinéa 251(5)b) de la Loi) au moment de l'acquisition des biens, si les biens ont été acquis dans des circonstances visées au paragraphe 1102(14) du Règlement, et autres

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provisions of Regulation 1102(14) were applicable, and other than property described in (i) or (ii) above that was created by an individual who was a Canadian, as defined by Regulation 1104(10)(a), at the time the property was created.

(f) property that is a camp, yacht, lodge or golf course or facility acquired after December 31, 1974 (subject to the transitional rules in Regulation 1102(17)) if any outlay or expense for the use or maintenance of that property is not deductible by virtue of paragraph 18(1)(l) (also see IT-148R2).

(g) propertyin respect of which a capital cost allowance for the purposes of paragraph 20(1)(a) is claimed and permitted under Part XVII of the Regulations by a farmer or fisherman.

Ownership

2. Capital cost allowance may only be claimed in respect of capital expenditures made in respect of property owned by the taxpayer or in which the taxpayer has a leasehold interest. In this connection it is important to note that in computing the income of a partnership, subsection 96(1) and Regulations 1102(1a) require that partnership property (including depreciable property) be accounted for as if it were owned at the partnership level.

3. In most instances, where a taxpayer incurs a cost in respect of a capital asset, ownership of or a lease to that asset will be obtained either at the time the cost was incurred or at a later date. However, there may be circumstances in which neither a freehold nor a leasehold interest in the property is acquired. If a taxpayer constructs and incurs the cost of a structure on land owned by another person, or otherwise incorporates an asset into property owned by another as an integral part thereof, and does not have a leasehold interest in or ownership of the asset, capital cost allowance may not be claimed in respect of such property. This will be the case where a road providing access to a taxpayer's plant is built at the taxpayer's expense on land owned by a municipality. Also, capital expenditures for architectural and engineering services in preparing plans and estimates for new plants, or for additions to existing plants or other construction work of a capital nature, are not subject to capital cost allowance if the work for which the plans and estimates were prepared is not carried out. However, an expenditure of this nature may be an eligible capital expenditure (defined in paragraph 14(5)(b)) for which an allowance is permitted by virtue of paragraph 20(1)(b) of the Act (see IT-143R2).

Capital Expenditures on Depreciable Property versus Current Expenditures on Repairs and Maintenance

4. The following guidelines may be used in determining whether an expenditure is capital in nature because depre-

que les biens décrits en (i) ou (ii) ci-dessus lorsque le particulier qui a créé le bien était un Canadien, au sens de l'alinéa 1104(10)a) du Règlement, au moment de la création du bien.

f) les biens qui sont un chalet, un bateau de plaisance, un pavillon, un terrain de golf ou des installations, acquise après le 31 décembre 1974 (sous réserve des règles transitoires prévues au paragraphe 1102(17) du Règlement), si le contribuable, pour l'usage ou l'entretien du bien visé, a déboursé une somme ou engagé une dépense qui n'est pas déductible aux termes de l'alinéa 18(1)l) (voir également le Bulletin d'interprétation IT-148R2).

g) les biens à l'égard desquels une déduction pour amortissement, aux fins de l'alinéa 20(1)a), est demandée par un agriculteur ou un pêcheur et autorisée en vertu de la Partie XVII du Règlement.

Propriété

2. La déduction pour amortissement ne peut être demandée que pour des dépenses en capital engagées à l'égard de biens que possède le contribuable ou à l'égard desquels il détient une tenure à bail. À cet égard, il faut noter qu'en calculant le revenu d'une société, le paragraphe 96(1) de la Loi et le paragraphe 1102(1a) du Règlement exigent que l'on tienne compte des biens de la société (y compris les biens amortissables) comme si ces biens étaient possédés au niveau de la société.

3. Dans la plupart des cas, lorsqu'un contribuable supporte le coût d'un bien en immobilisation, il en devient propriétaire ou locataire au moment du débours ou à une date ultérieure. Toutefois, il peut arriver, dans certains cas, qu'il n'acquière ni la pleine propriété ni la tenure à bail du bien. Si un contribuable construit une structure sur un terrain appartenant à une autre personne et qu'il en supporte le coût ou s'il incorpore par ailleurs un bien à des biens appartenant à une autre personne comme partie intégrante de ceux-ci, sans avoir une tenure à bail ou la propriété à l'égard de ce bien, la déduction pour amortissement ne peut être demandée pour ce bien. C'est ce qui se produit lorsqu'un chemin donnant accès à l'usine d'un contribuable est construit aux frais de ce dernier sur un terrain qui appartient à une municipalité. De même, les dépenses en capital engagées pour les services d'architectes et d'ingénieurs dont l'objet est de faire des plans et devis concernant de nouvelles usines, des rajouts à des usines ou d'autres travaux de constructions imputables au capital ne sont pas visées par la déduction pour amortissement, si les travaux pour lesquels les plans et devis ont été faits ne sont pas exécutés. Cependant, une dépense de ce genre peut être une dépense en capital admissible (définie à l'alinéa 14(5)b)) qui confère une déduction en vertu de l'alinéa 20(1)b) de la Loi (voir le Bulletin d'interprétation IT-143R2).

Dépenses en capital pour des biens amortissables par opposition aux dépenses courantes pour des réparations et de l'entretien

4. Les lignes directrices suivantes peuvent servir à déterminer si une dépense est imputable au capital parce que le bien amor-

ciable property was acquired or improved, or whether it is currently deductible because it is in respect of the maintenance or repair of a property:

(a) Enduring Benefit – Decisions of the courts indicate that when an expenditure on a tangible depreciable property is made "with a view to bringing into existence an asset or advantage for the enduring benefit of a trade", then that expenditure normally is looked upon as being of a capital nature. Where, however, it is likely that there will be recurring expenditures for replacement or renewal of a specific item because its useful life will not exceed a relatively short time, this fact is one indication that the expenditures are of a current nature.

(b) Maintenance or Betterment – Where an expenditure made in respect of a property serves only to restore it to its original condition, that fact is one indication that the expenditure is of a current nature. This is often the case where a floor or a roof is replaced. Where, however, the result of the expenditure is to materially improve the property beyond its original condition, such as when a new floor or a new roof clearly is of better quality and greater durability than the replaced one, then the expenditure is regarded as capital in nature. Whether or not the market value of the property is increased as a result of the expenditure is not a major factor in reaching a decision. In the event that the expenditure includes both current and capital elements and these can be identified, an appropriate allocation of the expenditure is necessary. Where only a minor part of the expenditure is of a capital nature, the Department is prepared to treat the whole as being of a current nature.

(c) Integral Part or Separate Asset – Another point that may have to be considered is whether the expenditure is to repair a part of a property or whether it is to acquire a property that is itself a separate asset. In the former case the expenditure is likely to be a current expense and in the latter case it is likely to be a capital outlay. For example, the cost of replacing the rudder or propellor of a ship is regarded as a current expense because it is an integral part of the ship and there is no betterment; but the cost of replacing a lathe in a factory is regarded as a capital expenditure because the lathe is not an integral part of the factory but is a separate marketable asset. Between such clear-cut cases there are others where a replaced item may be an essential part of a whole property yet not an integral part of it. Where this is so, other factors such as relative values must be taken into account.

(d) Relative Value – The amount of the expenditure in relation to the value of the whole property or in relation to previous average maintenance and repair costs often may have to be weighed. This is particularly so when the replacement itself could be regarded as a separate, marketable asset. While a spark plug in an engine may be such an asset, one would never

tissable a été acquis ou amélioré ou si elle est déductible parce qu'elle a été engagée pour réparer ou entretenir un bien:

a) Avantage durable – Selon les décisions rendues par les tribunaux, lorsqu'une dépense est faite à l'égard d'un bien amortissable corporel une fois pour toutes et en vue de créer un bien ou un avantage pour le bénéfice durable d'une entreprise, cette dépense est ordinairement considérée comme une dépense en capital. Toutefois, lorsqu'il est vraisemblable que de nouvelles dépenses du genre seront engagées pour remplacer ou renouveler un article en particulier parce que son utilité ne dépassera pas une période relativement courte, ce fait constitue une indication qu'il s'agit d'une dépense courante.

b) Entretien ou amélioration – Lorsqu'une dépense est engagée à l'égard d'un bien dans le seul but de le restaurer à son état d'origine, ce fait constitue une indication qu'il s'agit d'une dépense courante. Ce cas se présente souvent lorsque, par exemple, on remplace un plancher ou un plafond. Toutefois, lorsqu'une dépense a pour résultat d'améliorer sensiblement le bien par rapport à ce qu'il était à l'origine, par exemple un nouveau plancher ou un nouveau plafond nettement de meilleure qualité et plus durable que l'ancien, il faut alors considérer la dépense comme une dépense en capital. Le fait que la valeur marchande du bien augmente ou non par suite de la dépense n'est pas un facteur important dans la décision. Si la dépense comprend à la fois des éléments de dépense courante et de dépense en capital qui peuvent être identifiés, il faut procéder à la répartition pertinente des frais. Si seulement une faible partie de la dépense est une dépense en capital, le Ministère est prêt à considérer la dépense totale comme une dépense courante.

c) Partie intégrante ou bien séparé – Il peut y avoir lieu de déterminer également si la dépense a été engagée pour réparer une partie d'un bien ou pour acquérir un bien qui constitue en soi un bien distinct. Dans le premier cas, la dépense est vraisemblablement une dépense courante et dans le deuxième, une dépense en capital. Par exemple, le coût de remplacement d'un gouvernail ou d'une hélice de bateau est considéré comme une dépense courante, car il s'agit d'une partie intégrante du bateau et il n'y a pas d'amélioration; mais le coût de remplacement d'une machine dans une usine est considéré comme une dépense en capital, car la machine n'est pas une partie intégrante de l'usine mais un bien qui peut être vendu séparément. Entre ces cas bien tranchés, il y en a d'autres où un article remplacé peut être une partie essentielle d'un bien entier sans en être une partie intégrante. En pareil cas, d'autres facteurs, comme la valeur relative, doivent entrer en ligne de compte.

d) Valeur relative – Il y aura peut-être lieu d'évaluer le montant de la dépense par rapport à la valeur du bien entier ou par rapport à la moyenne des frais d'entretien et de réparation déjà engagés. Cela est particulièrement le cas lorsque le remplacement en soi peut être considéré comme étant un bien vendable distinct. Bien qu'une bougie dans un moteur puisse être un tel bien, personne ne considérerait

regard the cost of replacing it as anything but an expense; but where the engine itself is replaced, the expenditure not only is for a separate marketable asset but also is apt to be very substantial in relation to the total value of the property of which the engine forms a part, and, if so, the expenditure likely would be regarded as capital in nature. On the other hand, the relationship of the amount of the expenditure to the value of the whole property is not, in itself, necessarily decisive in other circumstances, particularly where a major repair job is done which is an accumulation of lesser jobs that would have been classified as current expense if each had been done at the time the need for it first arose; the fact that they were not done earlier does not change the nature of the work when it is done, regardless of its total cost.

(e) Acquisition of Used Property — Where used property is acquired by a taxpayer and at the time of acquisition it requires repairs or replacements to put it in suitable condition for use, the cost of such work is regarded as capital in nature even though, in other circumstances, it would be treated as current expense.

(f) Anticipation of Sale — Repairs made in anticipation of the sale of a property or as a condition of the sale are regarded as capital in nature. On the other hand, where the repairs would have been made in any event and the sale was negotiated during the course of the repairs, or after their completion, the cost should be classified as though no sale was contemplated.

Depreciable Assets versus Inventory Assets

5. The Department's practice with respect to a taxpayer who deals in a particular kind of property and who also uses that kind of property for some other purpose is discussed in IT-102R2.

Buildings Incidentally Acquired on Obtaining a Site

6. Where a taxpayer purchases real estate including a building and the building is torn down within a relatively short time after purchase, the question arises as to whether the building should be classed as depreciable property. If the building is demolished by the purchaser without having been used to earn income, the building cannot be regarded as depreciable property. Also, where the building is used to earn income for only a short time prior to demolition, it is not regarded as depreciable property unless the taxpayer can clearly establish that the prime intention on acquiring the building was for the purpose of gaining or producing income. The Department's practice with respect to the costs of demolishing a building incidentally acquired on obtaining a site is discussed in IT-485.

son coût de remplacement autrement que comme une dépense; mais, si le moteur lui-même est remplacé, la dépense ne vise pas seulement un bien vendable distinct mais peut également être très importante par rapport à la valeur totale du bien dont le moteur fait partie; dans ce cas, la dépense serait vraisemblablement considérée comme une dépense en capital. D'autre part, le rapport qui existe entre le montant de la dépense et la valeur du bien entier n'est pas en soi nécessairement décisif dans d'autres circonstances, spécialement lorsqu'est effectuée une réparation importante constituant une accumulation de petits travaux qui auraient été classés comme des dépenses courantes si chacun avait été fait au moment où le besoin s'était d'abord fait sentir; le fait que ces travaux n'aient pas été effectués plus tôt ne change pas la nature du travail lorsqu'il est fini, quel que soit son coût total.

e) Acquisition d'un bien usagé — Lorsqu'un contribuable acquiert un bien usagé et qu'il est nécessaire d'y apporter des réparations ou d'y remplacer des pièces pour le remettre en bon état afin qu'il puisse être utilisé, le coût de ces travaux est considéré comme une dépense en capital, même si, dans d'autres circonstances, il serait une dépense courante.

f) Perspective de vente — Les réparations faites en prévision de la vente d'un bien ou comme condition de cette vente sont considérées comme des dépenses en capital. Par contre, si les réparations auraient été faites de toute façon et que la vente a été négociée pendant le cours des réparations ou après qu'elles sont terminées, leur coût doit être classé comme si aucune vente n'avait été prévue.

Biens amortissables par opposition aux biens d'inventaire

5. Le Bulletin d'interprétation IT-102R2 traite de la position du Ministère à l'égard d'un contribuable qui fait le commerce d'un certain type de biens qu'il utilise également dans un autre but.

Immeubles acquis accessoirement à l'occasion de l'achat d'un emplacement

6. Si un contribuable achète des biens immobiliers comprenant un immeuble qui est démoli peu après l'achat, la question qui se pose est de savoir si l'immeuble doit être classé comme un bien amortissable. Si l'immeuble est démoli par l'acheteur sans être utilisé pour gagner un revenu, il ne peut pas être considéré comme un bien amortissable. De même, si l'immeuble est utilisé pour gagner un revenu uniquement pendant une courte période avant sa démolition, il n'est pas considéré comme un bien amortissable, sauf si le contribuable peut clairement prouver que son intention première en l'achetant était de gagner ou de produire un revenu. Le Bulletin d'interprétation IT-485 traite de la position du Ministère à l'égard des coûts de démolition d'un immeuble acquis accessoirement lors de l'achat d'un terrain.

APPENDIX C

QUEBEC COURT OF APPEAL DECISION IN *SMRQ* V. *GOYER*; LEAVE TO APPEAL TO SUPREME COURT OF CANADA REFUSED BY S.C.C. OCTOBER 21, 1987.

APPENDIX C

Quebec Court of Appeal decision in SMRQ v. Goyer; Leave to Appeal to Supreme Court of Canada refused by S.C.C. Oct. 21, 1987

UNABRIDGED REPORT OF THE JUDGMENT

The Court, adjudicating on the appeal against the judgment of the Provincial Court in the District of Montréal, held by Mr. Justice Rodolphe Bilodeau on February 28, 1984, in which he allowed the respondent's appeal from an assessment issued by the appellant and referred the said assessment back to the appellant to have a new one prepared in compliance with the judgment.

Following a hearing, a case study and a consultation;

On the grounds set out in Mr. Justice Vallerand's written opinion, tiled with this judgment and to which Justices Nichols and Lebel subscribe;

Allows the appeal in part and corroborates the assessment with regards to the rejection of the $200.78 deduction for interest and dividends;

Rejects the remainder of the appeal; the costs to be carried by the appellant, including extrajudicial costs not exceeding $1,500.

Mr. Justice Vallerand. This is the first time that the difference between expenditures of a capital nature deductible through capital cost allowance on the one hand, and, on the other hand, repair and maintenance expenses, deductible in full from the income in the year incurred, is debated before our Court.

The taxpayer, in this instance, the respondent, objected to an assessment from the Deputy Minister, in this instance, the appellant, in which the replacement of the aluminum windows, plumbing and balconies of her income-producing property was considered to be capital in nature. The appeal was brought before the Provincial Court who decided in favor of the respondent, hence the appeal of the Deputy Minister before our Court.

Relevant articles of the Act.(1)

128. A taxpayer may deduct, in computing his income from a business or property for a taxation year, only the outlays or expenses made or incurred by him during such year or payable in respect of such year, to the extent that they may reasonably be regarded as being related to such business or property and that they were made or incurred to gain income from such business or property and to the extent provided in this chapter, unless otherwise provided in this Part. 1972, c. 23, s. 117.

129. Such amounts shall not include any loss or replacement of capital, a payment or amount disbursed on account of capital or allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part. 1972, c. 23, s. 118.

The first judge, having referred summarily to a few precedents, writes:

From these cases, we have inferred the following general principles:

> 1. Maintenance expenses must be incurred with the intent to keep the property in its normal condition in order to generate taxable income.
> 2. Capital expenditures are those incurred
> a) to generate a new income or to increase the current income;
> b) to increase the value of the property which is susceptible to create a profit for the owner in the near or distant future (whether the profit is gained or not).
>
> In the said case, the evidence established the following:
>
> 1. The plumbing was totally inadequate and had to be completely redone.
> 2. The wooden floors of the balconies were completely rotten and also had to be redone.
>
> These two conditions do not normally exist in a building such as the one subject to the action: the municipality evaluates the duplex at approximately $100 000 and a potential buyer would certainly not expect to find its plumbing inadequate and its balconies unusable or dangerous. In short, the amounts spent by the taxpayer were paid out not to increase the value of the asset but to repair the defects created by lack of maintenance.
>
> The Deputy Minister's attorney indicated that the repairs in question would be long-lasting: that is all to the good of the Department then since these repairs will decrease the cost of maintenance and eventually increase the taxable income.
>
> I am convinced that, should these repairs have been spread over a five-year period, their deduction would have been allowed: I don't see why the taxpayer should be penalized for effecting them in a single year.

In his decision, the first judge, inadvertently it seems, omitted to deal with the doors and aluminum windows; according to the evidence submitted, the problem is the same as for the plumbing and balconies and, following his reasoning, I assume that he dealt with the doors and windows in a similar manner.

What is quoted on both sides illustrates well the difficulties at hand: several authorities whose opinions, when applied to a particular case, support, without reservation, one thesis or the other.

The appellant starts by recalling the Supreme Court of Canada's proposal:

> Parliament did not define the expressions outlay... of capital or payment on account of capital. There being no statutory criterion, the application or non-application of these expressions to any particular expenditures must depend upon the facts of the particular case.(2)

The National Assembly did not do better.

The appellant then quotes the Privy Council's Judicial Committee:

> But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.(3)

and indicates that the Supreme Court of Canada imported that judgment here.(4) I will come back to this reference which seems to support the respondent's proposal.

Then, after mentioning the Exchequer Court of Canada's judgment in the Glenco Investment Corp.(5), a case hardly useful for our purpose since it dealt with the improvement of a building to meet the requirements of a long term lease, the appellant refers to two other judgments of the Tax Revenue Board; the first one:

> In this particular appeal, I think that the matter of durability is perhaps the more important factor to be taken into account. A boiler that costs $3,700.00 - the sum paid for one of the new boilers - is a sizable piece of equipment by any standard of measurement and something that one buys rarely. It may sometimes call for repair, but only at long distant intervals will it be wholly replaced.(6)

The second judgment:

> It seems clearly established, however, that an expenditure made once and for all or else to create a lasting advantage, is essentially a capital expenditure and consequently, non-deductible. The evidence in this case clearly indicates that the amount of $3,427.25 spent in 1946 by the appellant, was not spent for ordinary maintenance and minor repairs: a new cement floor was laid, the building was rewired and considerable new plumbing was installed, besides repainting and building inside at least one new partition. The expenses occasioned by such work have been incurred, in my opinion, beyond question once and for all and to create a lasting advantage for the appellant.(7)

It is noted that, in each case, the Board considers the durability of the repairs to be a determining factor.

Following these, are several Provincial Court of Appeal decisions which accept the durability test.

After using this test for her argument, the respondent then refers to another decision of the Supreme Court of Canada:

> Among the tests which may be used in order to determine whether an expenditure is an income expense or a capital outlay, it has been held that an expenditure made once and for all with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade is of a capital nature. Expenditures to replace capital assets which have become worn out or obsolete are something quite different from those ordinary annual expenditures for repairs which fall naturally into the category of income disbursements.(8)

I will return later to this decision which, at first glance, but at first glance only, seems to prove the appellant right.

The respondent, on the other hand, challenges the principle of finality implied in the decisions and judgments quoted by the appellant. She starts by recalling the remarks made by Chief Justice Jackett of the Federal Court at the 1981 Corporate Management Tax Conference, and taken up in the Tax Appeal Board decision:

> Mr. Sherbaniuk has, however, invited me to comment on that jurisprudence. Having regard to the complexity of cases concerning capital transactions, I hesitate to do so. I can say that it seems to me to be a line of jurisprudence where lawyers and judges have, only too frequently, fallen into the trap of taking reasoning out of particular cases and erecting it into general principles. In my view, the once and for all test as amplified in British Insulated and Helsby Cables Ltd. typifies a principle resulting from falling into this trap. There is no test that I find less helpful for general application than the once and for all or enduring asset or advantage test.(9)

The respondent then quotes the following proposals:

> In effect, the ship has a double bottom -- an outside layer and an inside layer separated by appropriate structural members. If one or more plates constituting a part of the outside layer required to be replaced because they have been stove in or otherwise damaged, so long as the damage is not so extensive that the ship must be regarded as having been virtually destroyed and as having, in effect, ceased, from a business man's point of view, to exist as a ship, their replacement is, I should have thought, the most typical kind of ship repair. Where the inside layer of the ship's bottom, which also serves as the floor for the ship's cargo carrying holds, has to be replaced, in whole or

in part, by reason of wear and tear and of damage caused by the cargo carried in the ship, it seems clear to me that the expense falls in the same class as the expenses of replacement of portions of the outside skin. So long as the ship survives as a ship and damaged plates are being replaced by sound plates, I have no doubt that the ship is being repaired and it is a deductible current expense.

[The italics are from the undersigned.]

[...] I have not, however, been able to escape the conclusion that a replacement of a worn or damaged board or plate that is an integral part of an asset used in a business is a repair and that the costs of repairs are current expenses and not outlays of capital. I cannot accept the view that the cost of repairs ceases to be current expenses and becomes outlays of capital merely because the repairs required are very extensive or because their cost is substantial.(10)

Also, from the Federal Court of Appeal:

I am of the view that, if the replacement of the floor could otherwise be regarded as being the remedying of damage to the fabric of the building, it would have been properly deducted as a current expense on repairs notwithstanding

(a) that the damage arose from a hidden defect in the original structure and not from wear and tear, aging of materials or some accidental or malicious happening in the course of use, or
(b) that the damage was remedied in accordance with technology or knowledge as of the time thereof that incidentally effected an improvement in the structure over what it was when originally built.

The real problem, in my view, with regard to that part of the $95,198.10 that can reasonably be attributed to the replacement of the floor, is whether the replacement of the floor was merely the remedying of damage to the fabric of the building as it had theretofore existed or whether it was an integral component of a work designed to improve the building by replacing a substantial part thereof by something essentially different in kind.(11)

[The italics are from the undersigned.]

I share the respondent's opinion which, in my view, is in accordance with that of higher authorities. The importance of the repairs and of the resulting expenses are perhaps, in certain cases, an element of the solution. The same can be said for the durability of the repairs. But the essential question is whether the expenses to be deducted have resulted in creating a capital asset or in replacing one that had ceased to exist on the one hand, or, on the other hand, in

merely repairing an existing asset. In coming to this conclusion, I recall the proposal in the British Insulated decision of the Privy Council which I quoted in full earlier and which the appellant mistakenly believes he can use to his advantage.

> But when an expenditure is made, not only once and for all but with a view to bringing into existence an asset...(12)
>
> [The italics are from the undersigned.]

and, with due respect for the appellant who believes he can find assistance in the Haddon Hall Realty, I must say that the Supreme Court of Canada supports this proposal:

> [...] an expenditure made once and for all with a view to brinbing into existence an asset or adventage for enduring benefit of a trade is of a capital nature.(13)

Maintenance and repairs are effected to preserve a capital asset. As a rule, it is of little importance if a few boards on a balcony and a few lenghts of pipe are replaced each year -- the expenses incurred would unquestionnably be considered current maintenance expenses -- or that having neglected to maintain the property, major and lasting repairs have to be done. As long as a new capital asset is not created, that the normal value of the capital asset is not increased(14) and that an asset that had ceased to exist is not replaced by a new one, the repairs and maintenance in question are effected to restore the asset to its normal value.

In this case, the balconies, plumbing, windows and doors, as dilapidated as they were when they had to be replaced, do not constitute -- unlike the refrigerators and ranges in the Haddon Hall decision(15) -- the capital asset, but only some of its component parts, so much so that to replace these components does not constitute a replacement of the capital asset itself but only its repair. The proposal, which I quoted earlier from the Canada Steamship Lines(16) decision, illustrated this very well just as does the Haddon Hall decision, if only a contrario.(17)

Therefore, I am of the opinion that the appeal should be rejected, except for the $200.78 deduction for interest and dividends which the appellant waived before the first judge which, again inadvertently it seems, he forgot to mention in his remarks. The costs are to be carried by the appellant, including extrajudicial costs not exceeding $1,500 in accordance with the agreement of the parties.

References

(1) The Income Tax Act, (L.R.Q., c. 1-3).

(2) M.N.R. v. Algoma Central Railway, (1968) 22 D.T.C. 5096, 5097.

(3) British Insulated and Helsby Cables Ltd. v. Atherton, [1926] A.C. 205, 213-214.

(4) Montreal Light, Heat & Power Consolidated v. M.N.R. [1942] R.C.S. 89, 105.

(5) Glenco Investment Corp. v. M.N.R., (1967) 21 D.T.C. 5169.

(6) Slater and Laurier Avenue Apartments Ltd. v. M.N.R. (1960) 14 D.T.C. 305, 306.

(7) Yorkton Motors Ltd. v. M.N.R., (1949-50) 4 D.T.C. 276, 276-277.

(8) M.N.R. v. Haddon Hall Realty Inc., (1962) 16 D.T.C. 1001,1002.

(9) Healy v. M.N.R., (1984) 38 D.T.C. 1017, 1019.

(10) Canada Steamship Lines Ltd. v. M.N.R., (1966) 20 D.T.C. 5205, 5206-5207.

(11) Shabro Investments Ltd. v. R., (1979) 33 D.T.C. 5104. 5107.

(12) Supra, note 3, 213.

(13) Supra, note 8, 1002.

(14) Supra, note 5.

(15) Supra, note 8.

(16) Supra, note 10.

(17) Supra, note 8.

APPENDIX D

GOLD BAR DEVELOPMENTS v. R.

87 D.T.C. 5152

APPENDIX D
Gold Bar Developments v. R.
(from: 1987 Dominion Tax Cases)

5152

Gold Bar Developments Ltd. (successor by amalgamation to Gold Bar Developments Ltd. and Campus Corner Building Ltd.) (Plaintiff) v. Her Majesty The Queen (Defendant).

Federal Court—Trial Division, March 5, 1987. (Court File No. T-952-85.) (Received from the Court, March 19, 1987.)

Deductions—Revenue expense or capital expenditure—Repair of bricks on rental property —Income Tax Act, S.C. 1970-71-72, c. 63, ss. 18(1)(a) and (b).

The taxpayer corporation constructed an apartment building in 1966. In 1979, an inspection revealed that as a result of inferior work by the original brick sub-contractor the bricks were falling loose from the walls and the entire brick facing on one wall had become unsound. The taxpayer carried out the necessary repairs but used metal cladding instead of replacing the original brick or using brick veneer. The taxpayer deducted the cost of the repairs as a current expense. The Minister assessed the taxpayer on the basis that the cost of the repairs was a capital expenditure and the Tax Court of Canada (85 DTC 513) confirmed that assessment. The taxpayer further appealed to the Federal Court—Trial Division.

Held: **The taxpayer's appeal was allowed. The Court found that the taxpayer was entitled to deduct the cost of the repairs. It was not significant that the repairs improved the asset since this was to be expected. The "once-in-a-lifetime" approach was also not of much assistance since the more substantial the repair the less likely it was to recur. It was more helpful to emphasize the purpose of the repair. In this respect, it was the intention of the taxpayer to repair a condition which had become dangerous rather than to improve the asset. The taxpayer really had no choice in the matter. The expenditure was not so substantial as to constitute a replacement of the asset since it represented less than three per cent of the value of the asset. Finally, the Court was not satisfied that the use of metal cladding rather than brick improved the appearance of the building.**

Counsel: I. H. Pitfield for the plaintiff; N. A. Chalmers, Q.C. and L. Lytwyn for the defendant. Solicitors: Thorsteinsson, Mitchell, Little, O'Keefe & Davidson for the plaintiff; F. Iacobucci, Q.C., Deputy Attorney General of Canada for the defendant.

Before: Jerome, A.C.J.

[Issue]

THE ASSOCIATE CHIEF JUSTICE: This is an action pursuant to s. 172 of the *Income Tax Act* by way of appeal from a decision of the Tax Court of Canada [85 DTC 513]. The matter came on for hearing at Edmonton, Alberta, on October 29, 1986. At issue is the classification, for income tax purposes, of an expenditure by the plaintiff for the repair or replacement of walls of an apartment building in the City of Edmonton.

[Facts]

The facts are not complex. The plaintiff is an Alberta corporation formed from the merger on March 31, 1980 between the plaintiff and Campus Corner Building Limited. It constructed an apartment building in the City of Edmonton in 1966 and continuously owned and operated the property for rental income. In 1979, an inspection revealed that the bricks were falling loose from the walls and that the entire brick facing on the east wall had become unsound. Further

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analysis indicated that the primary cause was inferior work of the original brick subcontractor. On the advice of professional engineers, the plaintiff carried out the necessary repairs, using metal cladding instead of brick veneer, at a cost of $241,665.76. The plaintiff deducted the cost of the repairs in the computation of its income for the year ending March 31, 1980, and reported a loss in that year of $194,866.99. In the return for that year, the plaintiff invoked s. 111 of the *Income Tax Act*, applied $150,609.20 of the loss to its 1979 taxation year and filed an amended 1979 return accordingly.

On March 4, 1983, the Minister reassessed the plaintiff for both years by disallowing the deductions as repairs and reclassifying them as capital expenditures. The plaintiff filed Notices of Objection on May 12, 1983 and the Minister confirmed the re-assessments on October 24th of the same year. On January 12, 1984, the plaintiff launched an appeal to the Tax Court of Canada. The matter was heard in Edmonton on December 12, 1984 and by oral judgment delivered December 14, 1984, the plaintiff's appeal was dismissed. In written reasons filed, the concluding paragraph of the judgment of the learned Tax Court Judge is as follows:

> Both counsel cited tests from various authorities, none of which are absolute. One asks, "Would the building have had the same value in the marketplace when the problem of the falling bricks existed, as compared to a value after the problem was remedied?" I think not.
>
> A correction to the capital asset was needed: the expenditure was not of a recurring nature, but was made to bring about an advantage of an enduring nature to the capital asset.
>
> The expenditure was not a current expense made in the ordinary course of the company's business operation to earn income. Returning once again to the *Haddon Hall* case, Mr. Justice Abbott said at page 1002.
>
> "Expenditures to replace capital assets which have become worn out or obsolete are something quite different from those ordinary annual expenditures for repairs which fall naturally into the category of income disbursements."
>
> While in this case, there is no replacement of a worn out or obsolete capital asset there is a major expenditure made to put the capital asset in a proper condition, and certainly the expenditure is not an ordinary annual one.
>
> Applying then both a common sense approach to classify the expenditure and the test in the *Haddon Hall* case, I find that the expenditure in this case is of a capital nature and, accordingly, this appeal is dismissed.

With respect, I take a different view.

[*Analysis*]

I do not think the solution to this problem can be found in the effect of the expenditure. It is expected that repairs to a capital asset should improve it. Where the source of income is a residential apartment building, that is always the case, especially where the repairs are substantial. Nor do I find the "once-in-a-lifetime" approach of much assistance. The more substantial the repair, the less likely it is to recur (certainly the fervent hope of the building owner) but it remains a repair expenditure nonetheless.

I think it is more helpful to emphasize the purpose of the outlay by the taxpayer. What was in the mind of the taxpayer in formulating the decision to spend this money at this time? Was it to improve the capital asset, to make it different, to make it better? That kind of decision involves a very important elective component — a choice or option which is not present in the genuine repair crisis.

It is not in dispute that the plaintiff discovered in 1979 that the bricks were coming loose and falling on the ground around the building used by tenants and passersby. Obviously, it was a risk that would be unacceptable to the public, but also one likely to meet a reaction from city officials, in the extreme even closure of the premises. In the circumstances, I cannot conclude that the plaintiff had any real choice. To ignore that condition would certainly have brought about a reduction in occupation, or in rental income.

It is also common ground that the cause of the premature break-down of the brick veneer was faulty work by the original subcontractor when the plaintiff had arranged to have the building constructed some ten years earlier. That is not directly relevant to the taxation issue, but certainly verifies the fact that the plaintiff had this decision forced upon him and did not initiate it. This was not a voluntary expenditure with a view to bringing into existence a new capital asset for the purpose of producing income, or for the purpose of creating an improved building so as to produce greater income. The plaintiff was faced with an unexpected deterioration in the walls of the building which put the viability of the property at risk. The decision to spend the money was a decision to repair to meet that crisis and despite the fact that I am sure the plaintiff's expectation was, and still is, that it will not recur in the lifetime

of the building, it remains fundamentally a repair expenditure.

There remain two other considerations that arise from the jurisprudence. An expenditure which is in the nature of repair will not be allowed as a deduction from income if it becomes so substantial as to constitute a replacement of the asset. See *Canada Steamship Lines Limited v. M.N.R.*, 66 DTC 5205, [1966] CTC 125; *M.N.R. v. Haddon Hall Realty Inc.*, 62 DTC 1001, [1961] CTC 509; and *M.N.R. v. Vancouver Tugboat Company, Limited*, 57 DTC 1126, [1957] CTC 178. Here, however, while the sum of money is certainly substantial, the undisputed evidence is that this building's value at the material time was in the range of $8,000,000 so that the sum in issue represents less than 3% of the value of the asset. There is no justification therefore to reclassify the expenditure on that basis.

Finally, there have been a number of decisions in which repairs, either alone or in combination with other work, have rendered the capital asset not simply restored to its original condition, but greatly improved because of its new-found resistance to those factors which caused the deterioration. See *Shabro Investments Ltd. v. Her Majesty The Queen*, 79 DTC 5104, [1979] CTC 125; and *Sydney Harold Healey v. M.N.R.*, DTC 1017.

Counsel for the defendant invites me to reach that conclusion here because the walls to the plaintiff's building were not replaced with brick as before, but with a metal cladding that went beyond answering the defects, and made the building not only fully resistant to the problem of falling bricks, but also substantially improved in appearance. I cannot accept the suggestion, however, that once the decision to repair is forced upon the taxpayer, he must ignore advancements in building techniques and technology in carrying out the work. In remedying the situation, the plaintiff was given two or three options, including the replacement of the original brick. In pursuing the option of curtain-wall cladding, the plaintiff adopted an extremely popular modern construction technique. I am not satisfied that the appearance of the building was any better than it would have been had the original brick been replaced.

[Appeal allowed]

Nothing in this repair project attempted to change the structure of the building. What was done was neither more nor less than was required to replace the deteriorating and dangerous brick condition. The Minister was therefore in error in requiring the taxpayer to treat this as an expenditure on account of capital. The appeal is allowed and the matter will be returned to the Minister for the appropriate reassessment. Costs to the Plaintiff.

APPENDIX E

REVENUE QUEBEC INTERPRETATION

BULLETIN IMP 128-4/R1

Interpretation and administrative practice
concerning the laws and regulations

Interprétation Ministère du Revenu
3800, rue Marly
Sainte-Foy
G1X 4A5

Number: IMP 124-4
Date: December 21, 1987

Act(s): Taxation Act (R.S.Q., c. I-3), sections 128 and 129

Regulation(s):

Subject: Leasing of real property / operating expenses versus capital expenses

The purpose of this bulletin is to set forth the main criteria retained by Revenu Québec to determine if an expense incurred by a taxpayer in respect of an building from which he makes a leasing income, constitutes an eligible expense in computing his income, that is, a current expense or a non-eligible expense, i.e., an expense which must be capitalized in the cost of the building.

APPLICATION OF THE ACT

General considerations

1. Under section 80 of the Taxation Act, a taxpayer's income for a taxation year from property is his profit therefrom, subject to the provisions of Part 1.

2. Section 128 of the act allows a taxpayer to deduct in computing his income, only the outlays or expenses made or incurred by him during such year or payable in respect of such year, to the extent that they may reasonably be regarded as being related to such property and that they were incurred to gain income from such property, unless otherwise provided for in this Part.

3. In that respect, section 129 specifies that the expenses allowed by section 128 shall not include any replacement of capital, a payment or amount disbursed on account of capital.

4. Lastly, section 130 establishes that when such replacement, payment or amount is involved, the taxpayer may deduct the prescribed part or amount of the capital cost of such property.

5. It is thus essential to correctly identify an expense (current expense versus capital expense) in

order to measure exactly the profits derived from the leasing of a building and the capital cost of the building.

Establishing the nature of an expense

6. Generally, an expense incurred for the purpose of making a repair or carrying out the maintenance of a property is considered as an eligible current expense in computing income from the property.

7. Moreover, an expense incurred for the purpose of acquiring property, adding or improving property, is considered as an ineligible expense in computing the income from leasing of property and is capitalized to the cost of the property.

8. In order to establish the nature of the expense in the Goyer case, the Québec Court of Appeal decided that:

> "As long as a new capital asset is not created, that the normal value of the capital asset is not increased and that an asset that had ceased to exist is not replaced by a new one, the repairs and maintenance in question are effected to restore the asset to its normal value."

9. Furthermore, the Court explained that the term "asset" was to be taken to mean a complete asset in itself, not its component parts:

> "In this case, the balconies, plumbing, windows and doors, as dilapidated as they were when they had to be replaced, do not constitute (...) the capital asset but only some of its component parts, so much so that to replace these components does not constitute a replacement of the capital asset itself but only its repair."

10. Thus, in the process of establishing the nature of an expense, it is no longer relevant to know if the expense:

    1) is short-term or long-term;

    2) is likely to re-occur or not over the useful life of the property;

    3) is made once and for all or not;

    4) prevents or does not prevent deterioration of the property;

    5) brings or does not bring a lasting advantage to the property;

    6) represents or does not represent a major disbursement in relation to the value of the property.

11. On the other hand, it is essential to know if the expense resulted in:

    1) increasing the normal value of the asset;

2) replacing an asset that had ceased to exist;

3) creating a new asset; or

4) restoring the asset to its normal value, that is the value it would have if it were in very good condition.

12. For example, an expense incurred to replace all of the building's windows, or to repair the whole roof or the plumbing is considered an eligible expense to be deducted if it only resulted in bringing the building to its normal value. However, if a tax payer acquires a building at a price below its normal value and that, due to the condition of the asset when he bought it, he must incur an expense to bring the building back to its normal value, the expense must be capitalized.

13. On the other hand, the addition of a fireplace to the same building is a capital expense since it increases the normal value of the building.

14. Similarly, the addition of a garage to a building is a capital expense since it creates a new asset, that is, the garage.

15. In the event that a building is leased furnished, the purchase of new stoves and refrigerators to replace similar appliances constitutes a capital expense since there is a replacement of assets that have ceased to exist.

The present bulletin nullifies and replaces the October 26, 1984 bulletin IMP 128-4.

[1987] R.J.Q. 988 to 992

Court of Appeal
THE QUÉBEC DEPUTY MINISTER OF REVENUE V. DENISE GOYER

Income tax - deduction - expenditures of a capital nature or repair and maintenance expenditures.

Appeal from a judgment rendered by the Provincial Court which allowed the respondent's appeal from an assessment established by the appellant. Appeal dismissed except for the deduction of $200.78 for interest and dividends.

The appellant had decided that the replacement of the aluminum windows, plumbing and balconies of the revenue-producing property by the respondent was a capital expenditure. The property in question is a duplex evaluated at $100,000 by the municipality; its plumbing was inadequate and its balconies, doors and windows completely rotten.

The question for determination is whether the expenses resulted in creating a capital asset or in replacing one that had ceased to exist on the one hand, or, on the other hand, in simply repairing an existing capital asset. As long as a new asset is not created and the normal value of the asset is not increased or the asset that had ceased to exist is not replaced with a new one, the repair and maintenance expenses in question are incurred to restore the asset to its normal value. In this particular case, the balconies, plumbing, windows and doors of the building do not constitute a capital asset, but only some of its component parts; to replace these parts is not replacing the capital asset itself but merely repairing it.

Taxation Act, (L.R.Q., c.1-3), art 128, 129

Precedents

British Insulated and Helsby Cables Ltd. v. Atherton, [1926] A.C. 205; Canada Steamship Line Ltd. v. M.N.R., (1966) 20 D.T.C. 5205 (Ex. Ct.); Glenco Investment Corp. v. M.N.R., (1967) 21 D.T.C. 5169; Healey v. M.N.R., (1984) 38 D.T.C. 1017; M.N.R. v. Algoma Central Railway, (1968) 22 D.T.C. 5096; M.N.R. v. Haddon Hall Realty Inc., (1962) 16 D.T.C. 1001; Montreal Light, Heat & Power Consolidated v. M.N.R. [1942] R.C.S. 89; Shabro Investments Ltd. v. R., (1979) 33 D.T.C. 5104; Slater and Laurier Avenue Apartments Ltd. v. M.N.R., (1960) 14 D.T.C. 305; Yorkton Motors Ltd. v. M.N.R., (1949-50) 4 D.T.C. 276.

Justices Nichols, Vallerand and Lebel - C.A. Montréal 500-09-000420-844 (Mr. Justice Rodolphe Bilodeau, P.C. Montréal 500-02-047370-825, 1984-02-28),1987-04-15 -- Pierre Séguin for the appellant -- Antoine J. Chagnon for the respondent.